INDEPENDENT COMMUNITY
BANKERS of AMERICA®

June 17, 2022

Ms. Vanessa A. Countryman
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors [File No. S7-10-22]

Dear Ms. Countryman,

The Independent Community Bankers of America ("ICBA")[1] appreciates the opportunity to offer comments in response to the Securities and Exchange Commission's ("the SEC" or "the Commission") request for public comments on its proposed rule for the enhancement and standardization of climate-related disclosures for investors ("the Proposal" or "the Proposed Rule")[2]. ICBA is deeply concerned the SEC's Proposed Rule, while well intended, is the death-knell for participation in the public capital markets for community banks that are publicly held SEC registrants ("community bank registrants") – the staggering and unprecedented costs contemplated by this Proposal are untenable for community bank registrants to manage and will likely result in many delisting their stock and/or terminating their securities registration under Section 12 of the Securities Exchange Act of 1934 to avoid the associated costs and potential liabilities. Small community banks that are not publicly held will be unable or unwilling to join the public capital markets if the cost of doing so is prohibitive.

Unfortunately, as applied to community bank registrants, the Proposal is only superficially tiered or scaled, because the Commission's criteria for exceptive relief is tied to SEC filing status, not bank asset size. Unlike the recent climate-related financial risk management frameworks proposed by the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency ("OCC") which

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[1] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly $5.9 trillion in assets, over $4.9 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

[2] Securities and Exchange Commission, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, RIN 3235-AM87, 87 FR 21334, available at: https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors.

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fully exempted all community banks[3] with fewer than $100 billion in total consolidated assets from these proposed requirements, the SEC's Proposed Rule contains no similar exemption, and is therefore misaligned with the frameworks contemplated by community bank registrants' primary regulators.

While the SEC proposes to exempt "smaller reporting companies"[4] from some of the most onerous aspects of the Proposal, a significant number of community banks do not satisfy the criteria for smaller reporting companies based on their revenues and public float. As such, the Proposal subjects some of the nation's smallest community bank registrants (some with as few as $5 billion in total consolidated assets) to the same rigorous disclosure framework as the nation's largest, most systemically complex institutions (those with more than $3.3 trillion in total consolidated assets). No matter how well-intended the SEC's climate initiatives may be, this "one-size-fits-all" approach to mandatory and expensive climate-related disclosures is wrong, and will negatively impact community bank registrants, and the Main Street customers, investors, and local economies they proudly serve.[5]

ICBA is also troubled by the Proposal's departure from the United States Supreme Court's longstanding precedent governing the materiality of financial disclosures.[6] This established precedent, coupled with the SEC's existing rules, and the prudential bank regulatory agencies' current requirements for risk management, offer adequate, time-tested protections and disclosure frameworks for banks and their investors. A separate and shockingly complex climate-related disclosure framework (explained in no less than 490 pages in the Proposal) is not only unnecessary but will also be unduly burdensome for community bank registrants to implement in any way that is practical or cost-feasible.

The Proposal is extraordinarily broad, and requires disclosure of speculative climate-related risks; climate-related effects on strategy, business model and outlook; board and management oversight of climate-related issues; processes for identifying, assessing, and managing climate risks; plans for transition; financial statement metrics related to climate; greenhouse gas ("GHG") emissions; and climate targets and goals. This Proposed Rule would not only require community bank registrants to evaluate climate-related risks in virtually every aspect of bank operations and risk management, and collect climate data directly from their customers (the vast majority of whom, as small, privately held businesses and households, do not collect GHG information) but would also require community bank

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[3] For more information on the community bank model, and the notable lending strengths that differentiate community banks from their large bank competitors, please refer to Appendix A.

[4] The Commission's rules define a "smaller reporting company" as an issuer that is not an investment company, an asset-backed issuer, or a majority owned subsidiary of a parent that is not a smaller reporting company and that (1) had a public float of less than $250 million; or (2) had annual revenues of less than $100 million for the previous year and either (i) no public float; or (ii) a public float of less than $700 million. *See* 17 CFR 299.10(f)(1), 230.405, and 17 CFR 240.12b-2.

[5] In response to the Dodd-Frank Act, the prudential bank regulators specifically excluded community banks from 13 of the 14 "major" implementing rules designed to curb actual systemic risk that caused the Great Recession. Yet, the SEC's Proposed Rule, which anticipates only hypothetical systemic risk associated with climate change (since no climate-related financial crisis has, in fact, occurred), inexplicably does not set forth a similar community bank exemption.

[6] *TSC Industries, Inc. v. Northway,* 426 U.S. 438 (1976).

registrants to do so without the materiality standard that has long served as a benchmark for identifying necessary information that must be disclosed to investors.

Additionally, ICBA is concerned the Proposal strays from the SEC's statutory mandate and assumes responsibility for climate oversight belonging to other agencies, such as the Environmental Protection Agency, without any Congressional directive to do so.[7] The SEC's use of a disclosure framework to broaden its authority to climate oversight and climate disclosure enforcement is legally questionable, appears to be politically motivated, and will disproportionately affect the community bank registrants the SEC regulates. Indeed, one likely effect is that financial institutions of all sizes may be incentivized to "choke-off" lending to and investments in companies that are engaged in lawful but climate-disfavored industries to avoid or minimize climate-disclosure burden under the Proposal.

While community banks typically are not the primary source of financing for large energy producing companies, they do provide the majority of small business credit in those communities where energy production, refinement, transportation and other ancillary businesses exist. To the extent the Proposal reinforces an "Operation Chokepoint"[8] regulatory strategy, the SEC's climate disclosure policies are likely to paradoxically accelerate or be the source of the same transition risks the SEC seeks to avoid.

As stewards of their local communities, community bankers have every incentive to ensure their lending practices support the long-term prosperity of their local economies. Unlike large banks (those with assets greater than $100 billion) community banks cannot flourish without the success of their local communities because their customers and loan portfolios are geographically concentrated within the local markets these community banks serve. The risks of economic shocks, customer displacement and damaged collateral (risks the SEC characterizes in the context of climate change as "transition risks" and "physical risks") are not novel risks for community banks to manage, and each of these risks, if material, undoubtedly has the potential to impact a community bank registrant and its investors. But history has shown that because community banks are experts in managing their risks and disclosing their material risks, community banks do not fail, and community bank investors are not harmed, simply because climate-related financial risks exist. Because the shareholder base of community banks and community bank holding companies is small, and because community banks do not pose systemic risk, the SEC should meaningfully exempt all community bank registrants from the Proposal and relieve these

[7] *See* Joseph A. Grundfest, *The SEC is Heading Toward a Climate Train Wreck*, Washington Post (April 5, 2022) where former SEC Commissioner Grundfest observes, "courts could easily conclude that the SEC lacks statutory authority to mandate greenhouse gas (GHG) disclosures. That authority might instead belong to the Environmental Protection Agency. The logic supporting this conclusion is simple. Not a word in federal securities law- or the in the legislative history of those laws- speaks to climate disclosures. The SEC's authority to mandate disclosures relies entirely on inference from those sources. Those inferences are solid, strong, and sensible, and would likely carry the day but for one uncomfortable fact that the commission's proposal assiduously ignores: In 1974, Congress passed the Clean Air Act, which expressly delegates authority to the EPA to mandate GHG emission disclosures."

[8] Operation Chokepoint was a misguided government initiative of the FDIC and the Department of Justice ("DOJ") to pressure financial institutions to decline banking services to certain categories of lawfully operating merchants that were associated with high-risk activities. On August 16, 2017, the DOJ sent a letter to the Chairman of the U.S. House of Representatives Committee on the Judiciary effectively ending Operation Chokepoint because the DOJ concluded "law abiding businesses should not be targeted simply for operating in an industry that a particular administration might disfavor."

financial institutions from the significant and consequential cost and compliance burdens that will negatively impact their Main Street customers.

I. ICBA Recommendations

Because regulatory climate-disclosure and risk management frameworks are only in the nascent stages of development, and because the Proposal is deeply flawed, ICBA strongly urges the SEC to revise and repropose the Proposed Rule through a subsequent notice and comment period before finalizing any rule. A revised and reproposed rule will enable both the SEC and the public to further study this issue, thoroughly review the thousands of comments submitted, and provide more meaningful feedback than was feasible during this brief, initial comment period.[9]

ICBA appreciates the difficult task the SEC assumed by drafting a framework that affects every publicly held company, and we understand it is impossible for the SEC to align with every regulatory body across every industry subject to the Proposal. However, the banking industry is uniquely different from other SEC-regulated industries because banks are the direct conduits for consumers, investors, and businesses to access deposits and capital. Given the critical role banks, and in particular, community banks have in supporting the economy, and providing consumers and small businesses access to capital, the SEC must ensure its rulemaking does not block, restrict, or discourage banks, consumers, small businesses, and investors' access to credit or participation in the capital markets. Additionally, given the close nexus between the banking and investment industries, it is crucially important the SEC ensure its proposed framework closely aligns with the rules, regulations, guidance, and proposals issued by the FDIC, OCC, and Board of Governors of the Federal Reserve System ("the Federal Reserve")(collectively "the prudential bank regulators").

To accomplish these goals, ICBA encourages the SEC to adopt the following recommendations:

- Align with the prudential bank regulators by creating a full exemption from the SEC's climate disclosure framework for all community bank registrants with fewer than $100 billion in assets, regardless of public filing status. Here, community bank registrants would continue to be required to disclose material climate risks to their investors, consistent with current practices.

- Alternatively, and at the very least, exempt all community bank registrants, regardless of public filing status, from Scope 3 disclosure requirements to best fulfill the spirit of exempting "smaller reporting companies" from Scope 3 disclosure requirements.

- Ensure any final rule abides by the longstanding principles of materiality set forth in *TSC Industries, Inc. v. Northway*.[10]

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[9] When a proposed rule is as broad and consequential as this Proposal, agencies typically solicit public comment for 90 days or more, however, the SEC has permitted this Proposal only a short comment period of 67 days. While we appreciate the SEC extending the time for the public to comment on this Proposal from 36 to 67 days, additional time, analysis, and public dialogue is still needed to best guide the development of any final rule.

[10] 426 U.S. 438 (1976).

- Leverage existing SEC rules, and risk management supervision practices mandated by the FDIC, OCC, and the Federal Reserve, to simplify the Proposal and ensure any final rule is not overly complex and does not unnecessarily duplicate existing regulatory requirements or unduly burden community bank registrants.

- Protect scenario analysis as a voluntary, exploratory exercise by removing the requirement from the Proposal that scenario analysis methodology must be disclosed if these exercises are performed.

- Recommend to the OMB, for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA") that any final rule on this topic, which drastically amends the SEC's current disclosure framework, constitutes a "major rule."

II. The Proposed Rule is improperly scaled because it only provides limited Scope 3 disclosure exemptions to "smaller reporting companies" but does not partially or fully exempt all community bank registrants with fewer than $100 billion in assets from the disclosure framework.

In the Proposal's preamble, the SEC explains the Proposed Rule includes "a number of features designed to mitigate the burdens on registrants such as phase-in periods for the proposed climate-related disclosure requirements, a safe harbor for certain emissions disclosures, and an exemption from certain emissions reporting requirements for smaller reporting companies."[11] Yet, for community bank registrants that are not "smaller reporting companies," these features do nothing to mitigate compliance burden because the SEC proposes to subject the nation's smallest banks, which are not presently required to collect and disclose climate data (a zero cost framework), to a framework that by the SEC's own estimates will cost each registrant, on average, between $490,000 and $640,000 in the first year of compliance alone.[12]

Because many community banks are "large accelerated filers,"[13] the SEC proposes these small bank registrants should be subject to the most rigorous, and therefore, most expensive and burdensome aspects of the Proposal. As proposed, community banks that are "large accelerated filers" (many of which hold fewer than $10 billion in assets) will be subject to the same Scope 3 disclosure requirements, implementation period, and scenario analysis disclosure requirements as the nation's largest, most complex, and systemically important or "too big to fail" institutions.

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[11] Proposal at 15.

[12] Proposal at 373.

[13] *See* fn. 123 of the Proposal defining a "large accelerated filer" as "an issuer after it first meets the following conditions as of the end of its fiscal year: (i) The issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use the requirements for SRCs under the SRC revenue test."

Community banks do not have comparable resources to the large banks that that hold hundreds of billion or trillions in assets and are thousands of times bigger; and community banks and their customers do not have a trove of climate-data readily at their disposal to collect, examine, or disclose. Given their finite resources, and inexperience with any climate disclosure framework, the SEC should follow the lead of the OCC and the FDIC by providing a full exemption from the climate disclosure framework to community bank registrants with fewer than $100 billion in assets. Otherwise, the Commission's Proposed Rule will disproportionately impact community bank registrants due to basic economies of scale.

Research performed by the Federal Reserve Bank of St. Louis confirms the costs of compliance are especially burdensome for smaller banks because economies of scale exist in compliance, i.e., relative compliance costs increase with decreases in bank size. [14] Small community banks reported compliance costs that averaged almost 10 percent of noninterest expense, while the largest banks in the study reported compliance costs that averaged 5 percent. In other words, the compliance cost burden for the smallest community banks is double that of the largest community banks."[15] It follows, then, that the compliance cost burden for the smallest community banks to comply with the proposed climate disclosure framework is significantly greater, potentially thousands of times greater, than that of the largest banks in the nation.

Similarly, the Federal Reserve Bank of Philadelphia Research Department has studied the impact of regulatory burden on small banks and has concluded "regulations can impose significant costs if they increase regulatory reporting and compliance requirements . . .[a]nd to the extent that these costs are not divisible – for example, if the bank must hire a lawyer to ensure its regulatory compliance – then the small bank may be at a competitive disadvantage compared with a large bank that already has a legal department."[16]

To put this burden in perspective, economists at the Minneapolis Federal Reserve "developed a simple methodology for estimating compliance costs for very small banks, measured by the cost of adding an employee dedicated solely to managing regulatory compliance. They estimate that 40 basis points is the minimum return on assets that investors require of a small bank. They find that nearly 18 percent of banks with less than $50 million in assets would fall below this minimum return if they had to hire an additional full-time employee, while 2.5 percent of banks with assets of $500 million to $1 billion would fall below the minimum."[17]

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[14] Federal Reserve Bank of St. Louis, *Compliance Costs, Economies of Scale and Compliance Performance: Evidence from a Survey of Community Banks* (April 2018) at page 1, available at: https://www.communitybanking.org/~/media/files/compliance%20costs%20economies%20of%20scale%20and%20compliance%20performance.pdf.

[15] *Id.* Survey data was collected in 2015, 2016, and 2017 by the Conference of State Bank Supervisors from almost 1,100 community bank and thrift institutions.

[16] James Disalvo and Ryan Johnston, Federal Reserve Bank of Philadelphia Research Department, *How Dodd-Frank Affects Small Bank Costs: Do Stricter Regulations Enacted Since the Financial Crisis Pose a Significant Burden?* First Quarter 2016, page 17, available at: https://www.philadelphiafed.org/the-economy/banking-and-financial-markets/banking-trends-how-dodd-frank-affects-small-bank-costs.

[17] *Id.* 40 basis points is the historical return on assets for a de novo bank after 5 years.

As the Commission acknowledges in the Proposal, based on previous public feedback from large cap firms about climate-related disclosure costs, by one estimate "headcount requirements ranged from two to 20 full-time equivalent employees . . . [f]ees for external advisory services ranged from $50,000 to $1.35 million annually, which generally included legal counsel and consulting services related to environmental engineering, emissions, climate science, modeling, or sustainability reporting."[18]

Separately, another commenter "reports that their services in calculating client companies' GHG footprints (Scopes 1, 2, and 3 emissions) would initially cost $75,000 to $125,000 if the client company has no prior experience in this area."[19] And the Commission itself acknowledges "[r]egistrants that are accelerated filers and large accelerated filers will incur additional costs in obtaining assurance of Scopes 1 and 2 emissions disclosures. The SEC estimates that for reasonable assurance, accelerated filers will incur costs ranging from $50,000 to $100,000, while large accelerated filers will incur costs ranging from $115,000 to $235,000."[20]

If the hiring of a single employee is enough to erode the return on assets that investors require of a small bank, how can any community bank possibly hire the number of employees and specialized third-parties necessary to comply with the SEC's Proposal? The answer is simple: it cannot.

On the basis of costs alone, community bank registrants cannot afford to hire an army of climate experts to comply with the Proposed Rule. But additionally, it is not apparent, and the SEC has failed to explain, where community bank registrants, many of them located in rural areas, are supposed to find individuals qualified to perform this work.[21] If finalized, the overwhelming and sudden demand from every publicly held company in the nation competing to hire from a limited pool of qualified climate experts, consultants, accountants, compliance specialists and attorneys, will inevitably drive up the costs for these individuals' services and will force the majority of smaller registrants to spend countless hours sourcing this talent and expertise.

On its face, the SEC's cost-benefit analysis suggests this Proposed Rule cannot be finalized without imposing a steep, troubling, and undue regulatory burden. The SEC's analysis, which likely underestimates the costs of compliance, calculates that this single proposal will increase the overall burden of collecting information from all publicly held companies' S-1, S-4, S-11, 10, 10-K, 10-Q, F-1, F-4, 20-F, and 6-K forms from $3,856,959,756 annually to $10,235,031,998 – a program change that is 2.5 times greater than the current burden.[22] This is a consequential program change that is unusually high for an agency rulemaking that Congress has not directed the SEC to perform. Because these exorbitant

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[18] Proposal at 393-394.

[19] Proposal at 396.

[20] Proposal at 400.

[21] Similarly, the SEC has not acknowledged the difficulties registrants will have in identifying individuals with climate expertise to serve in governance roles.

[22] Proposal at 459-450.

regulatory costs will disproportionately impact community banks and their customers, any final rule should be tailored to apply only to large banks with more than $100 billion in assets.

III. At a minimum, all community bank registrants with fewer than $100 billion in total assets, including those who are large accelerated filers, accelerated filers, and non-accelerated filers should be exempt from the Proposal's Scope 3 disclosure requirements.

As previously explained, ICBA urges the SEC to fully exempt all community banks from its proposed climate disclosure framework. However, at a minimum, the SEC should extend its Scope 3 exemption for "smaller reporting companies" to all community banks with fewer than $100 billion in assets, regardless of their public filing status. Measuring Scope 3 emissions would require community bank registrants to collect Scope 1 and 2 emissions throughout the entirety of the bank's value chain, i.e., all of the bank's customers, vendors, and third-party service providers. For community banks, gathering this information from their customers presents a significant hurdle because their customers are not otherwise required to collect or maintain nebulous greenhouse gas (GHG) emissions data, are unlikely to know how to collect this data without hiring third-party expertise, and are likely unwilling or unable to pay additional expense to gather this data.

Because collecting Scope 3 emissions data presents unique, and enormously complex operational challenges compared to Scope 1 and 2 emissions, the Proposal correctly exempts some small companies from the requirement to collect and disclose this data. For example, "[i]t may be difficult to obtain activity data from suppliers and other third parties in a registrant's value chain, or to verify the accuracy of that information. It may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data . . . [and] calculating and disclosing Scope 3 emissions could represent a challenge for certain registrants, in particular those that do not currently report such information on a voluntary basis."[23] The SEC should be commended for responding to these concerns by creating a Scope 3 disclosure exemption for smaller companies. However, the exemption is not broad enough.

While the spirit of the Scope 3 exemption for "smaller reporting companies" is to address concerns "the Commission would impose a 'one size fits all' approach, which could disproportionately impact smaller registrants,"[24] this exemption is flawed because it does not extend to all of the community bank registrants it was designed to capture. Therefore, as currently proposed, many community bank registrants that are not "smaller reporting companies" will, in practice, be subject to a "one-size-fits-all" framework as the Proposal does not meaningfully differentiate between community banks and their large bank competitors. To properly scale the framework, and ensure all community bank registrants receive the same exceptive relief from climate-disclosure requirements, the SEC must tie the exemption criteria to bank asset size (community banks with less than $100 billion in assets) and not filing status. Not only will this approach ensure fair treatment among community bank registrants under the SEC rules, it will also provide consistency between the SEC and the prudential bank regulators.

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[23] Proposal at 218-219.

[24] Proposal at 222.

IV. The SEC's climate disclosure framework departs from the longstanding principles of materiality established by the United States Supreme Court.

ICBA strongly urges the SEC to revise the Proposal to maintain the Commission's current, voluntary disclosure regime which requires disclosures of climate risks only when the company considers them material to an investor. The SEC and community bank registrants have long abided by the United States Supreme Court's precedent whereby a climate related issue is to be considered "material" to an investment decision, and therefore should be disclosed, when there is a "substantial likelihood that the disclosure of the omitted fact would be viewed by the reasonable investor as significantly altering the total mix of information available."[25] The existing materiality standard limits the amount and type of information disclosed to investors so that there is a clear nexus between the information disclosed and its relevance to the financial return of an investment.

ICBA agrees with Commissioner Peirce that "the [P]roposed [R]ule dispenses with materiality in some places and distorts in others."[26] The Proposal broadly requires "all public companies to disclose all Scope 1 and 2 greenhouse gas emissions, and the financial metrics do not have a materiality qualifier."[27] Further, the Proposal "also directs companies to speculate about the habits of their suppliers, customers, and employees; changing climate policies, regulations and legislation; technical innovations and adaptations; and changing weather patterns."[28] This exercise becomes exponentially more complex and convoluted in the context of collecting and disclosing Scope 3 emissions data from bank customers. By abandoning the materiality standard, the Proposal favors over-disclosure of climate information – a result which the SEC assumes will result in more consistent, useful disclosures to investors. Yet, without the guardrails of materiality governing the registrant's decisions on which types of information to disclose, the Proposal leaves it up to each individual investor to sort through a massive amount of disclosure to ascertain what may or may not be material. The over-disclosure of climate information without any limiting distinction between material and immaterial disclosures will be unduly burdensome for registrants, more difficult for investors to navigate than the SEC presumes, and will result in inconsistent disclosures by registrants.

V. The Proposal is unnecessary and unduly burdensome for community bank registrants because existing SEC rules require material climate related risks to be disclosed to investors, and bank supervisory requirements adequately protect community banks, their customers, and their loan portfolios from physical and transition risks.

ICBA encourages the SEC to scale back its Proposal, and leverage existing SEC rules and bank supervisory requirements for climate-related disclosures. Inconsistent and duplicative regulations among the SEC and the prudential bank regulators will unnecessarily burden community bank registrants with labor and compliance costs and other expense, particularly when the current framework has adequately supported the public capital markets for decades.

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[25] 426 U.S. 438 (1976).

[26] Commissioner Hester M. Peirce, *We are Not the Securities and Environment Commission- At Least Not Yet* (March 21, 2022) available at: https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321.

[27] *Id.*

[28] *Id.*

A. Existing SEC Rules

Under existing rules, community banks are required to disclose financially material risks, including those related to climate risks. For example:

- Item 303 of Regulation S-K, *Management's Discussion and Analysis of Financial Conditions and Results of Operations*, requires disclosure of "material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition."[29]

- Item 101 of Regulation S-K, *Description of Business*, requires a description of the registrant's business, including each reportable segment, and specifically requires disclosure of the material effects that compliance with environmental regulations may have on the capital expenditures, earnings and competitive position of the registrant.[30]

- Item 103 of Regulation S-K, *Legal Proceedings*, requires a description of material pending legal proceedings, including those related to the environment.[31]

- Item 105 of Regulation S-K*, Risk Factors*, broadly requires disclosure of "material factors that make an investment in the registrant or offering speculative or risky."[32]

- Securities Act Rule 408 and Exchange Act Rule 12b-20 require companies to disclose "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."[33]

B. Existing Bank Supervisory Requirements

The ICBA agrees with the SEC that "[h]ow a company assesses and plans for climate-related risks may have a significant impact on its future financial performance and investors' return on their investment in the company."[34] However, as community banks know from over a century of lending experience, the mere existence of climate-related risk is not necessarily material, or alarming, and does not *ipso facto* threaten bank safety and soundness, the economy as a whole, or create systemic risk for the financial system. In fact, in a recent New York Federal Reserve staff report titled, "*How Bad Are Weather*

[29] 17 CFR § 229.303.

[30] 17 CFR § 229.101.

[31] 17 CFR § 229.103.

[32] 17 CFR § 229.105.

[33] 17 CFR § 230.408 and 17 CFR § 240.12b-20.

[34] Proposal at 13.

Disasters for Banks?" ("the Staff Report"), the financial regulator evaluated all FEMA disasters and found "generally insignificant or small effects on bank performance and stability. In particular, loan losses and default risk at local banks [did] not increase significantly . . . [m]oreover, not all effects are bad; income of multi-county banks increase significantly with disaster exposure."

According to the Staff Report, "local banks" (i.e. community banks) have "superior geographic knowledge" that "helps them avoid areas where disaster risks are more frequent than expected based on common knowledge."[35] Community banks have superior geographic knowledge as compared to their large-bank counterparts because "banks located closer to their borrowers have been found to harbor knowledge of both borrowers and local risk that more distant lenders may lack."[36] For example, "local banks reallocated mortgage lending from census tracts where flood risks seem understated relative to the FEMA maps (given recent flooding experience)."[37] By contrast, the Staff Report's authors did not observe similar behavior at multi-county banks.[38]

The detailed findings from the New York Federal Reserve are strong evidence community banks are properly managing climate-related financial risks, and should, therefore, not be required to disclose every conceivable or immaterial climate risk to investors, even if doing so notionally satisfies a desire for uniform disclosures. Since the late 19th century, community banks have successfully implemented risk management practices, and in so doing, have weathered and survived every type of natural disaster, including catastrophic hurricanes, tornadoes, earthquakes, wind events, droughts, freezes, snowstorms, wildfires, landslides, volcanoes, and flooding. Community banks' current, validated, and long-standing risk management practices are not only adequate for community banks to evaluate climate-related financial risks, but they are also effective in ensuring community banks are operationally resilient and protected from failure in the aftermath of economic shocks and natural disasters.

Community banks are well-equipped to prepare for and respond to natural disasters and property losses. Under the bank regulators' existing framework, all community banks are subject to rigorous examination, supervision, and oversight from their primary prudential regulators in the following areas: (1) disaster preparedness and response; (2) concentration risk management; (3) underwriting practices and estimations of allowance for loan and lease losses ("ALLL"); and (4) securing insurance policies to offset risk.

1. Disaster Preparedness and Response

Community banks maintain detailed business continuity plans which outline the processes the bank will follow before, during, and after a natural disaster to safeguard employees, customers, products and

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[35] Staff Reports, Federal Reserve Bank of New York, *How Bad are Weather Disasters for Banks?*, No. 990 (Nov. 2021) at page 9 (emphasis added) available at: https://www.newyorkfed.org/research/staff_reports/sr990.

[36] *Id.*

[37] *Id.*

[38] *Id.*

services, and remain operational with limited business disruption.[39] These disaster plans are not obscure documents buried in dusty file drawers but are instead meticulously prepared, diligently tested, and carefully guarded reference guides that bank employees are ready to follow at any moment's notice. Business continuity plans not only contemplate the physical destruction of bank property, including the bank headquarters, ATMS, and branches, but also detail how the bank will respond to the needs of its customers and the community-at-large, and, in particular cash needs, in the aftermath of a disaster's destruction. As part of these plans, community banks proactively ensure they have enough cash on hand to meet customer needs and that redundant systems are in place so customers can continue to use debit cards and banks can readily access digitally stored bank records. Community banks also contemplate how bank employees can continue to utilize operationally critical systems and communicate with bank personnel, emergency responders, regulators, customers, and vendors in the event there is a loss of power, loss of physical bank records, inaccessible roadways, and displaced bank employees and customers.

2. Concentration Risk Management

Community banks are also adept in managing other types of risks, such as concentration risk, under the existing risk management frameworks mandated by their prudential bank regulators. Every community bank portfolio is concentrated geographically, thus all community banks are exposed to some degree of credit concentration risk. Yet, exposure to concentration risk, even significant concentration risk, is not indicative that a bank will fail or that the bank should be subject to heightened regulatory scrutiny. Instead, the relevant inquiry is whether the concentration risk is material and whether the bank has properly managed its risk exposures. To measure the materiality of concentration risk, community banks and their regulators evaluate the quantity of risk exposures, the quality of a bank's risk management framework, the strength of bank governance, the adequacy of internal controls, and perform stress tests. As demonstrated during thousands of examinations, community banks are adept in mitigating risk due to seasonal weather changes and natural disasters, and credit concentration and should not be subject to additional burdensome, costly, duplicative, and unnecessary climate-related risk management practices.

3. Underwriting Practices and Estimating Allowance for Loan and Lease Losses ("ALLL")

Existing due diligence and underwriting practices enable community bankers to carefully assess the level of risk posed by every customer relationship and ensure effective controls are in place to monitor these relationships on an ongoing basis. If necessary, community banks will shorten the maturity of their loans to protect the bank not only from interest rate risk but also from many different types of underwriting risks including climate risks.

Additionally, under the current supervisory framework for estimating credit losses, banks are expressly required to consider "qualitative or environmental factors that are likely to cause estimated credit losses

[39] *See* Federal Deposit Insurance Corporation FIL-62-2017, *Interagency Supervisory Examiner Guidance for Institutions Affected by a Major Disaster* (Dec. 15, 2017). *See also* FFIEC, *Business Continuity Management Booklet* available at: https://ithandbook.ffiec.gov/it-booklets/business-continuity-management.aspx.

associated with the institution's existing portfolio to differ from historical loss experience."[40] The FDIC and other prudential bank regulators expect allowance estimates for ALLL to be "based on a comprehensive, well-documented, and consistently applied analysis of the loan portfolio, and should take into consideration all available information existing as of the financial statement date, including environmental factors such as industry, geographical, economic, and political factors."[41]

Plainly stated, the qualitative and environmental factors community banks currently use to analyze the adequacy of ALLL already estimate and quantify climate-related financial risk. For example, if a bank is located in a market that is in severe drought, the bank will increase qualitative and environmental factors to account for this increased risk to the loan portfolio, which in turn results in an increase in the bank's allowance estimate. Since community banks already consider qualitative and environmental factors as part of their "comprehensive, well-documented, and consistently applied ALLL analysis," and since most community banks will be subject to the Financial Accounting Standards Board's Current Expected Credit Losses ("CECL") standard by 2023 and be required to be forward looking with their estimates of loan losses, a separate climate risk and disclosure framework is unnecessary.

4. Securing Insurance Policies to Offset Risk

With respect to their lending and investment activities, community banks are keenly aware of the importance of risk mitigation particularly during times of economic stress or extreme weather events. To mitigate climate, disaster, and concentration risks, community banks ensure loans secured by real estate have adequate flood and other hazard insurance and their agricultural loans have adequate crop insurance. Crop insurance allows agricultural producers to recover from severe weather disasters and repay their farm loans.

Additionally, community banks diversify their agricultural loan portfolios by utilizing the safety nets, insurance, and market protections for farmers and agricultural lenders authorized by the farm bill, including the Farm Service Agency's Guaranteed Farm Loan Programs. The farm bill, adopted by Congress approximately every five years, provides an income safety net for commodity prices to bolster income for farmers and ranchers. The farm bill also offers farmers and ranchers several guaranteed farm loan programs. The guaranteed farm loan programs protect up to 90 – 95 percent of the loan principal, thus ensuring the repayment of most of the loan principal should farmers and ranchers become unable to repay their loans. These programs also help protect community banks against loan losses by providing tools to manage their concentration risks, which is particularly important to banks that specialize in agricultural lending.

VI. The SEC should incentivize registrants to use scenario analysis only as a voluntary, exploratory tool.

ICBA applauds the SEC for not proposing to mandate that registrants conduct scenario analysis. However, we are concerned that because the Proposal requires registrants to disclose methodologies,

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[40] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of Thrift Supervision, *Interagency Policy Statement on the Allowance for Loan and Lease Losses,* available at: https://www.fdic.gov/regulations/laws /rules/5000-4700.html.

[41] *Id.*

assumptions, and qualitative and quantitative information to investors when scenario analysis is performed, the Proposed Rule will discourage registrants from using scenario analysis as an exploratory tool. When conducted on a voluntary basis, scenario analysis may help institutions analyze and test climate related financial risk management and identify gaps in current practices. Therefore, we encourage the SEC to incentivize registrants to perform voluntary scenario analysis by removing the Proposal's requirement that scenario analysis methodologies be disclosed when these exercises are performed. This requirement discourages registrants from performing scenario analysis because the costs of disclosing methodologies are high, and there is a risk investors may misinterpret the results of scenario analysis, particularly because the underlying models and methodologies of these exercises are evolving. As such, the SEC should revise the Proposal's scenario analysis requirements to ensure these exercises remain voluntary, and do not impose heightened disclosure requirements on financial institutions that may choose to participate in these exploratory exercises.

VII. <u>The Proposal constitutes a "major rule" for purposes of SBREFA.</u>

For the reasons discussed above, it is evident the Proposal is a "major rule" based on the estimated costs set forth in the SEC's cost-benefits analysis. Registrants will bear significant additional costs to collect and disclose climate related data - an estimated program change of $6,378,073,242- resulting in annual effect on the economy of at least $100 million, if finalized. Additionally, the estimated costs associated with Scope 3 disclosure framework provide further justification the Proposed Rule will have a major increase in costs or prices for consumers and individual industries. The Proposal will require banks to begin collecting climate data from their customers, meaning individuals and small businesses that are otherwise not required to collect this data, and are not subject to the SEC's direct supervision, will likely be compelled to do so as a condition of obtaining credit. Because these steep and intrusive compliance costs may disincentivize public companies, including community bank registrants, from participating in the public markets, the Proposal is also likely to have significant adverse effects on competition, employment, and U.S. based enterprises. Therefore, the SEC should recommend that OMB find the Proposal constitutes a "major rule."

I. <u>Conclusion</u>

ICBA is concerned the Proposed Rule's disclosure compliance costs and implementation challenges pose an insurmountable hurdle for community bank registrants to overcome. We encourage the SEC to ensure all community bank registrants with fewer than $100 billion in assets are fully exempt from any climate disclosure framework, and at a minimum, that all community bank registrants are exempt from a requirement to collect Scope 3 emissions data from their customers. Should you wish to discuss our positions in further detail, please feel free to contact Jenna Burke at [redacted].

Sincerely,

/s/ Jenna Burke
Senior Vice President, Senior Regulatory Counsel
Independent Community Bankers of America

Appendix A

Unlike large banks that operate under a national or regional footprint and whose officers and employees are detached from the communities in which the bank operates, community banks' business models are built on relationship banking and civic loyalty and has a local focus. Community banks are deeply involved in their local communities, and they channel their loans to the neighborhoods where their depositors live and work. Community banks serve as the only physical banking presence in nearly one in five U.S. counties. More than 16 million people in roughly one in three counties would have limited or no physical access to mainstream banking services without the presence of community banks.

Because community banks are small businesses, they understand the needs of small business owners in their community and studies show they are the primary and preferred lenders of small businesses. Small Business Administration data show that community banks have served as the unequivocal leaders of the U.S. economic recovery from the pandemic due to their outsized role as Providers of the Paycheck Protection Program ("PPP") small-business loans. According to the data, community banks were the predominant PPP lenders to local small businesses – their 4.7 million PPP loans accounted for nearly 60% of the program's total loan amount. Community banks outperformed the rest of the banking industry in serving minority-owned, women-owned and veteran-owned businesses, accounting for 86.9% of total loans made to minority-owned businesses, 81% of total loans made to women-owned businesses and 68.9% of total loans made to veteran-owned businesses. Community banks made more than 90% of PPP loans to communities with an average household income of less than $40,000 per year, and more than 75% of PPP loans to communities with a poverty rate of at least 20%. Community banks also made PPP loans in 98.5 % of low-income or economically distressed counties and 97% of rural counties.