

Federal Housing Finance Agency
Office of Inspector General



**FHFA Has Laid the Groundwork
to Integrate Consideration of
Climate-Related Financial Risk into
its Policies and Programs
but Plans and Methodologies to
Accomplish This Work Are in the
Early Stages of Development**



AUD-2022-008

June 23, 2022

Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) is charged by the Housing and Economic Recovery Act of 2008 with the supervision of Fannie Mae and Freddie Mac (together, the Enterprises); Common Securitization Solutions, LLC, (CSS) an affiliate of the Enterprises; and the Federal Home Loan Bank System (collectively, the regulated entities). FHFA's mission as a federal financial regulator is to ensure the safety and soundness of its regulated entities so that they serve as a reliable source of liquidity and funding for housing finance and community investment. FHFA has served as conservator of the Enterprises since 2008. In addition, FHFA is a member agency of the Financial Stability Oversight Council (FSOC), which is composed mainly of federal financial regulators. One of FSOC's primary purposes is to identify risks to the financial stability of the U.S. and to respond to emerging threats to the stability of the U.S. financial system.

According to a 2021 FSOC report, over the past decade, there has been growing attention from financial regulators, business leaders, investors, and policy makers around the world to the threat that climate change poses to financial systems and economies at global, national, and local scales. The report concluded that in the United States and across the globe, climate-related impacts in the form of warming temperatures, rising sea levels, droughts, wildfires, intensifying storms, and other climate-related events are already imposing significant costs upon the public and the economy.

On May 20, 2021, the President issued Executive Order (EO) 14030, Climate-Related Financial Risk. EO 14030 lays out a policy to advance disclosure of climate-related financial risk, to act to mitigate climate-related financial risk and its drivers, and to achieve the Administration's target of a net-zero emissions economy by no later than 2050. EO 14030 also directs FSOC to, consistent with applicable law and subject to the availability of appropriations, consider issuing a report on the efforts by its member agencies to integrate consideration of climate-related financial risk in their policies and programs. FSOC's Report on Climate-Related Financial Risk was issued on October 21, 2021, and contained over 30 recommendations applicable to FSOC member agencies.

We performed this audit to determine and report on what actions FHFA has taken to integrate consideration of climate-related risk into its policies and programs for the regulation and supervision of the regulated entities as of February 28, 2022, and whether those actions are consistent with the applicable policies, objectives, and directives of EO 14030.



AUD-2022-008

June 23, 2022

We found that, in January 2022, FHFA established an inter-divisional Steering Committee and working groups structure to address pertinent aspects of EO 14030 and to facilitate work needed to identify and address climate-related financial risk in its regulated entities. The Deputy Director of FHFA's Division of Research and Statistics (DRS) is the Steering Committee Chair. Not surprisingly, given the recency of EO 14030, FHFA's work on climate-related financial risk is in the early stages as of the end of our review period. Accordingly, working group project plans and the methodologies by which FHFA will integrate consideration of climate-related financial risk into its policies and programs for the regulation and supervision of the regulated entities have not yet been fully developed.

We make one recommendation in this report to address our findings. In a written management response, FHFA agreed with the recommendation.

This report was prepared by James Lisle, Audit Director; April Ellison, Audit Manager; and Christopher Mattocks, Auditor; with assistance from Abdil Salah, Assistant Inspector General for Audits. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfa.org, and on www.oversight.gov.

James Hodge, Deputy Inspector General for Audits /s/

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ABBREVIATIONS

| | |
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| Charter | FHFA’s Climate Change and ESG Steering Committee Charter |
| CSS | Common Securitization Solutions, LLC |
| DBR | Division of Federal Home Loan Bank Regulation |
| DER | Division of Enterprise Regulation |
| DRS | Division of Research and Statistics |
| Enterprises | Fannie Mae and Freddie Mac |
| EO | Executive Order |
| ESG | Environmental, Social, and Governance |
| FHFA or Agency | Federal Housing Finance Agency |
| FHLBanks | Federal Home Loan Banks |
| FSOC | Financial Stability Oversight Council |
| FY | Fiscal Year |
| GAO | Government Accountability Office |
| GAO’s Leading Practices | GAO’s Leading Practices in Collaboration Across Governments, Nonprofits, and the Private Sector |
| PAR | Performance & Accountability Report |
| Steering Committee | Climate Change and ESG Steering Committee |

BACKGROUND.....

Executive Order 14030

In EO 14030, Climate-Related Financial Risk, issued May 20, 2021, the President lays out the Administration’s policy to: “advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk...including both physical and transition risks; act to mitigate that risk and its drivers, while accounting for and addressing disparate impacts on disadvantaged communities and communities of color...and spurring the creation of well-paying jobs; and achieve our target of a net-zero emissions economy by no later than 2050.”¹

Among other things, this EO directed the Secretary of the Treasury, as chair of FSOC, to consider a range of actions for assessing, sharing relevant data, and reporting on climate-related financial risk, consistent with applicable law and subject to the availability of appropriations. This included direction that the Secretary of the Treasury consider issuing a report to the President within 180 days of the date of the order (November 16, 2021) on any efforts by FSOC member agencies to integrate consideration of climate-related financial risk in their policies and programs. FSOC responded to the EO directive by issuing the FSOC Report on Climate-Related Financial Risk on October 21, 2021.² That report includes recommendations that FSOC and its members can adopt, which FSOC says are to strengthen the financial system and make it more resilient to climate-related shocks and vulnerabilities.

FHFA Has Made Climate-Related Financial Risk a Supervisory Priority

In its role as conservator, FHFA issues annual Scorecards to the Enterprises and CSS to communicate its priorities and expectations for the Enterprises and to provide transparency to the public about these expectations. FHFA’s 2022 Scorecard instructs each Enterprise to “Ensure a governance structure exists to prioritize the effects of climate change throughout Enterprise decision making.” In addition, both FHFA’s Division of Enterprise Regulation

¹ According to FSOC, physical risks refer to harm to people and property arising from increased frequency and severity of acute extreme weather events, such as wildfires, hurricanes, floods, and heat waves, as well as longer-term shifts in the climate, including, but not limited to, changes in precipitation patterns, sea-level rise, and ocean acidification. Transition risks are defined by FSOC as referring to stresses to certain sectors and institutions arising from changes in public policies, technologies associated with the changes necessary to limit climate change, or consumer and business sentiment.

² FSOC, *Report on Climate-Related Financial Risk* (Oct. 21, 2022) (online [here](#)).

(DER) and Division of Federal Home Loan Bank Regulation (DBR) have designated climate change as a supervisory priority for examinations of the regulated entities in 2022.³

Leading Practices for Collaboration

FHFA's Director has acknowledged that the efforts to address climate-related financial risk will require collaboration with FSOC member agencies and other stakeholders. Further, the Government Accountability Office (GAO) has stated that achieving important national outcomes requires coordinated efforts. In line with this, GAO has identified a set of practices for structuring collaboration among federal, state, and local governments, as well as the nonprofit and private sectors (GAO's Leading Practices).⁴ We used GAO's Leading Practices as a starting point and consulted other sources of guidance, such as GAO's *Standards for Internal Control in the Federal Government* (Green Book) and the Project Management Institute's *A Guide to the Project Management Body of Knowledge*, sixth edition (PMBOK Guide), to compile a list of practices that we could use to assess whether the structure that FHFA has put in place to address climate-related financial risk facilitates collaboration within FHFA. Our list of practices includes:

- Clearly identify initiative objectives that are consistent with integrating consideration of climate-related risk into its policies and programs, and the entity's regulatory purview, and then identify planned outcomes.
- Define roles and responsibilities of leadership and committee members, delegate sufficient authority, and facilitate participation of subject matter experts from each of FHFA's significant regulatory functions.
- Establish a common methodology to support collaborative work.
- Establish mechanisms to manage resources, and monitor, evaluate, and report on results.
- Reinforce accountability for collaborative efforts through Agency plans and reports.

³ Supervisory priorities were communicated via individual supervisory letters to Fannie Mae and Freddie Mac on Feb. 1, 2022, and communicated via supervisory letters to the FHLBanks on Dec. 18, 2020, and Dec. 22, 2021, respectively.

⁴ GAO, *Leading Practices in Collaboration Across Governments, Nonprofits, and the Private Sector*.

FACTS & ANALYSIS

FHFA Has Established a Climate Change and ESG Committee Structure, Consistent With Leading Practices for Collaboration, to Integrate Consideration of Climate-Related Financial Risk Into its Policies and Programs, but Specific Plans and Methodologies to Accomplish this Work Are Still in Development

FHFA has been engaged in gathering information related to climate change.⁵ On January 19, 2022, FHFA created a new structure for its climate change efforts by issuing its Climate Change and ESG Steering Committee Charter (Charter).⁶ We reviewed this structure to determine whether it was designed to address key requirements of the EO and FSOC’s recommendations, and for consistency with the adapted leading practices for collaboration.

FHFA’s Climate Change and ESG Steering Committee Charter Sets Objectives That Are Consistent with Integrating Consideration of Climate-Related Financial Risk into its Policies and Programs

The Charter defines objectives and states that the purpose of the Climate Change and ESG Steering Committee (Steering Committee) is to provide the Agency with advice and recommendations regarding FHFA’s ability to effectively oversee the regulated entities’ risk management of the threats posed by climate change and the anticipated transition to a low-carbon economy. The goals of the Steering Committee are: to better understand the impact of climate change on the housing and mortgage markets, including the disparate impacts on disadvantaged communities; to facilitate the sharing of climate-related financial risk data among FSOC members; and to propose policies that will ensure the regulated entities

⁵ In November 2020, FHFA established a Natural Disaster Risk Working Group, which is now referred to as the Climate and Natural Disaster Risk Working Group. In March 2021, FHFA also established an ESG Working Group. Both were inter-divisional working groups designed to coordinate FHFA’s climate-related risk activities. In January 2021, FHFA requested information on climate-related financial risks from the public to inform its activities by issuing *Climate and Natural Disaster Risk Management at the Regulated Entities Request for Input*. FHFA received roughly 60 responses from various submitters, including, among others, regulated entities, climate scientists, advocacy groups, and data vendors. In March 2021, the Climate and Natural Disaster Risk Working Group held a public listening session on Climate and Natural Disaster Risk Management at the Regulated Entities with nearly 20 external speakers. FHFA also sought out various external entities to provide presentations that furthered FHFA’s knowledge and understanding of climate-related financial risks. In addition, FHFA officials began communicating with FSOC officials in April 2021 to discuss how FSOC should engage on climate risks.

⁶ ESG is the acronym for Environmental, Social, and (Corporate) Governance, the three broad categories, or areas of interest, for what some have termed “socially responsible” investors. These are investors who consider it important to incorporate certain values and concerns (such as environmental concerns) into their selection of investments instead of simply considering the potential profitability or risk of investment loss presented by an investment opportunity.

continue to perform their broader missions in the housing finance market in a safe and sound manner by addressing climate-related risks.

FHFA Has Delegated Authority for Leadership of its Climate Change and ESG Steering Committee, Defined Roles and Responsibilities of Leadership, and Facilitated Participation by Subject Matter Experts from All Major Divisions and Offices of FHFA

FHFA has designated the Deputy Director of DRS as the Chair of FHFA’s Climate Change and ESG Steering Committee and has granted him or her the authority to approve, in consultation with FHFA’s Office of Budget and Financial Management, the commitment of funds for expenditures.⁷ The Charter describes roles and responsibilities of the committee chair and defines the Steering Committee’s activities to include, among other things: (1) making policy, technical, operational, and other recommendations to the Director; (2) establishing working groups to address issues and inquiries as assigned by the Steering Committee; and (3) reviewing, overseeing, and approving activities, plans, products, and priorities of the working groups. The Steering Committee is comprised of FHFA division and office heads from each of the major divisions and offices of FHFA.⁸

FHFA’s Climate Change and ESG Steering Committee and Working Groups Are Structured to Address Pertinent Aspects of EO 14030, But Individual Working Group Methodologies are Still in Development

The Charter established an initial set of eight working groups to perform work needed to integrate consideration of climate-related financial risk into FHFA’s policies and programs. These working groups along with the FHFA office(s) responsible for leading the group and key summarized portions of the group’s initial purpose statement are as follows:

- Data and Research Working Group (DHMG, DRS) – collect appropriate data and develop plans to resolve data and methodological gaps.

⁷ FHFA Order No. 8, DRS Delegated Authorities and Responsibilities (Jan. 19, 2022). With regard to the commitment of funds for expenditures, the Deputy Director of DRS’ ability to commit funds is subject to the Director’s approval or non-objection.

⁸ Voting Steering Committee members include: Deputy Director, Division of Housing Mission and Goals (DHMG); Deputy Director, Division of FHLBank Regulation (DBR); Deputy Director, Division of Enterprise Regulation (DER); Deputy Director, Division of Conservatorship Oversight and Readiness (DCOR); Deputy Director, Division of Accounting and Financial Standards (DAFS); Deputy Director, Division of Research and Statistics (DRS); Director, Office of Equal Opportunity and Fairness (OEOF); Director, Office of Minority and Women Inclusion (OMWI); Director, Office of Congressional Affairs and Communications (OCAC); General Counsel, Office of General Counsel (OGC); Chief Operating Officer, Office of the Chief Operating Officer (OCOO); and Representation from the Office of the Director (as determined by the Director).

- Assessing Exposure to Climate Change Working Group (DHMG, DBR) – develop guidance on climate-related stress tests and scenarios to be run by the regulated entities.
- Reporting and Disclosures Working Group (DAFS) – provide guidance on the standard(s) the Enterprises and FHLBanks should meet and frequency of reporting on ESG.
- Governance Working Group (DER, DBR) – develop guidance for all regulated entities by outlining expectations for minimum standards of climate change governance/ESG, including dedicated board committee, executive sponsor, management committee, and adequate staffing, to ensure ESG factors are included in operational decision making.
- Consumer Protection Working Group (DHMG) – develop framework for evaluating climate-related policy and programmatic changes that includes an assessment on impacts to historically under-served communities.
- Green Bonds⁹ Working Group (DHMG, DCOR) – engage with industry stakeholders to understand the market for green bonds.
- Legal Working Group (OGC) – advise Steering Committee and working groups on legal matters.
- Agency Working Group (OCOO) – develop a plan for the Agency to reduce FHFA’s climate footprint.

Taken along with the Steering Committee, these working groups provide a structure to address pertinent parts of EO 14030 and recommendations in the FSOC Report on Climate-Related Financial Risk that are applicable to FHFA (for example, FHFA’s Consumer Protection Working Group is responsible for addressing the EO policy requirement of “accounting for and addressing disparate impacts on disadvantaged communities”). However, methodologies by which each working group will assess and address its assigned aspect of climate-related financial risk and the deliverables (and associated timelines and milestones) by which FHFA will integrate consideration of climate-related financial risk into FHFA’s policies and programs have not yet been fully developed. According to the Deputy Director of DRS, FHFA is in the early stages of planning for this work.

⁹ Green bonds are issued by governments, organizations, and companies to finance environmental and climate projects exclusively.

FHFA’s Climate Change and ESG Steering Committee Charter Establishes Mechanisms to Manage Resources, and Monitor, Evaluate, and Report on Results, But Project Plans for Each Working Group Are in the Process of Development

The Charter provides mechanisms to leverage and manage resources, and monitor, evaluate, and report on results. According to the Charter, the Steering Committee will meet on a periodic basis, at the call of the committee chair, but no less than once per quarter, and minutes will be kept for all Steering Committee meetings.

Further, the Charter calls for each working group to have a chair or co-chairs, participant list, statement of purpose, and project plan. Working groups are responsible for maintaining minutes of their respective meetings, maintaining records and documents in accordance with applicable FHFA policy and Steering Committee directions, and reporting progress on their assigned tasks. Working groups must submit revised project plans to the Steering Committee for approval at the beginning of each calendar year. As of the completion of our fieldwork, FHFA has developed initial project plans for each working group. However, FHFA officials told us that FHFA is in the early stages of planning for this work, and the working groups’ purpose statements and related project plans are “living documents” (subject to change as more information is learned).

FHFA Has Reinforced Accountability for Collaborative Efforts Through Agency Reports

As mentioned, FHFA’s Director has acknowledged that the efforts to address climate-related financial risk will require collaboration with FSOC member agencies and other stakeholders. Consistent with this position, FHFA has reinforced accountability for collaborative efforts through agency reports and plans. For example, FHFA’s Fiscal Year (FY) 2021 Performance & Accountability Report (PAR) states that FHFA will work to ensure that its regulated entities prioritize and establish adequate governance structures to ensure that the effects of climate change are considered in their decision making. FHFA’s FY 2021 PAR also states that FHFA will continue to work collaboratively with other government agencies on issues related to the effects of climate change on vulnerable communities and on challenges related to data limitations and incomplete tools to assess climate risks. Further, FHFA issued its FY 2022-2026 Strategic Plan on April 14, 2022. The Strategic Plan includes an objective to identify options for incorporating climate change into regulated entity governance.

FINDING

FHFA has established a Climate Change and ESG committee structure to integrate consideration of climate-related financial risk into its policies and programs, but specific plans and methodologies to accomplish this work are still in development.

CONCLUSION

We found that, in January 2022, FHFA established an inter-divisional Steering Committee and working groups to address pertinent aspects of EO 14030 and facilitate the work needed to identify and address climate-related financial risk in its regulated entities. Since FHFA’s work on climate-related financial risk is in the early stages, working group project plans and the methodologies by which FHFA will integrate consideration of climate-related financial risk into its policies and programs for the regulation and supervision of the regulated entities have not yet been fully developed.

RECOMMENDATION

Consistent with leading practices for collaboration, we recommend that FHFA’s Steering Committee Chair ensure that the working groups complete developing project plans and methodologies, with corresponding timelines and milestones, for deliverables needed to integrate consideration of climate-related risk, consistent with EO 14030, into its policies and programs for the regulation and supervision of the regulated entities.

FHFA COMMENTS AND OIG RESPONSE

We provided FHFA management an opportunity to respond to a draft of this audit report. FHFA management provided a written management response, which is included as an Appendix to this report. In its management response, FHFA agreed with our recommendation and stated that integrating consideration of climate-related risk into its policies and programs for the regulation and supervision of the regulated entities is an ongoing initiative, and FHFA will provide a status update on the development of project plans and methodologies, with corresponding timelines and milestones, by June 1, 2023.

We consider FHFA’s planned corrective action responsive to our recommendation.

OBJECTIVE, SCOPE, AND METHODOLOGY

We performed this audit to determine and report on what actions FHFA has taken to integrate consideration of climate-related risk into its policies and programs for the regulation and supervision of the regulated entities and whether those actions are consistent with the applicable policies, objectives, and directives of EO 14030, Climate-Related Financial Risk as of February 28, 2022.

To accomplish our objective, we:

- Researched and identified EOs, including EO 14030, relevant to climate-related financial risk to gain an understanding of FHFA’s requirements and responsibilities under applicable EOs.
- Reviewed prior FSOC, GAO, OIG, and White House reports related to climate-related financial risk as well as Project Management Institute guidance, including the following:
 - FSOC Report on Climate-Related Financial Risk (Oct. 21, 2021)
 - GAO, Leading Practices in Collaboration Across Governments, Nonprofits, and the Private Sector
 - GAO, CLIMATE CHANGE Potential Economic Costs and Opportunities to Reduce Federal Fiscal Exposure (Dec. 19, 2019) (GAO-20-338T)
 - GAO, 2021 High Risk List, HIGH-RISK SERIES Dedicated Leadership Needed to Address Limited Progress in Most High-Risk Areas (March 2021) (GAO-21-119SP)
 - FHFA-OIG, Disaster Risk for Enterprise Single-Family Mortgages (Mar. 23, 2021) (WPR-2021-004)
 - White House, A Roadmap To Build A Climate-Resilient Economy (Oct. 14, 2021)
 - Project Management Institute, *A Guide to the Project Management Body of Knowledge* (Sixth Edition)
- Reviewed FSOC’s Report on Climate-Related Financial Risk to familiarize ourselves with actions that FHFA reported it had taken related to climate-related financial risk as of the issuance date of the report, and to determine the FSOC Report recommendations applicable to FHFA.

- Determined that two components of GAO’s *Standards for Internal Control in the Federal Government* (Green Book) were significant to our objective: (1) control environment, and the underlying principle that management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives as well as the attribute that management establishes expectations of competence for key roles, and other roles at management’s discretion, to help the entity achieve its objectives; and (2) risk assessment, and the underlying principles that management should define objectives clearly to enable the identification of risks and define risk tolerances, and that management should identify, analyze, and respond to risks related to achieving the defined objectives.
- Adapted GAO’s *Leading Practices in Collaboration Across Governments, Nonprofits, and the Private Sector* to develop leading practices for collaboration. In adapting GAO’s leading practices, we consulted other sources of guidance such as GAO’s Green Book and the Project Management Institute’s *A Guide to the Project Management Body of Knowledge*, sixth edition (PMBOK Guide).
- Interviewed FHFA officials to gain an understanding of actions, taken and planned, regarding climate-related financial risk, and obtained and reviewed documentation supporting these actions, including:
 - FHFA Committee Charter Policy (Policy 803) (Dec. 6, 2017)
 - FHFA Climate Change and ESG Steering Committee Charter (Jan. 19, 2022)
 - FHFA Order No. 8, DRS Delegated Authorities and Responsibilities (Jan. 19, 2022)
 - FHFA’s 2022 Scorecard for the Enterprises and CSS (Nov. 2021)
 - DER’s 2022 supervisory priorities for the Enterprises
 - DBR’s 2022 and 2021 supervisory priorities for the FHLBanks
 - Documentation of meetings and presentations by FHFA, the regulated entities, and private sector entities related to climate-related financial risk
 - FSOC Report on Climate-Related Financial Risk recommendations and FHFA’s planned response to each recommendation they determined to be applicable
- Compared FHFA’s actions, taken and planned, regarding climate-related financial risk, including the structure that FHFA has put in place to address climate-related financial risk, to EO 14030, recommendations in FSOC’s Report on Climate-Related

Financial Risk and the adapted leading practices for collaboration, to determine whether FHFA's actions were consistent with these sources of guidance.

We conducted this performance audit from October 2021 to June 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX: FHFA MANAGEMENT RESPONSE.....

CONTROLLED



Federal Housing Finance Agency

MEMORANDUM

TO: James Hodge, Deputy Inspector General for Audits, Office of Inspector General

FROM: Daniel E. Coates, Deputy Director, Division of Research and Statistics **DANIEL COATES**

SUBJECT: Draft Audit Report: *FHFA Has Laid the Groundwork to Integrate Consideration of Climate-Related Financial Risk into its Policies and Programs but Plans and Methodologies to Accomplish This Work Are in the Early Stages of Development*

DATE: June 7, 2022

Digitally signed by DANIEL COATES
Date: 2022.06.07
10:14:05 -04'00'

Thank you for the opportunity to review the Office of Inspector General's (OIG) draft report referenced above (Report).

We are pleased that the OIG concluded that FHFA has established a Climate Change and ESG committee structure in accordance with EO 14030 to integrate the consideration of climate-related financial risk into its policies and programs. We are additionally appreciative that, within the Report's recommendation, the Report also provided an explicit mention as to the recent issuance of EO 14030 and to FHFA's work on climate-related financial risk being within the early stages as of the end of the review period.

The report makes one recommendation, with which FHFA agrees.

Recommendation 1: Consistent with leading practices for collaboration, the OIG recommends that FHFA's Steering Committee Chair ensure that the working groups complete developing project plans and methodologies, with corresponding timelines and milestones, for deliverables needed to integrate consideration of climate-related risk, consistent with EO 14030, into its policies and programs for the regulation and supervision of the regulated entities.

Management Response: FHFA agrees with this recommendation. This is an ongoing initiative, and FHFA will provide a status update on the development of project plans and methodologies, with corresponding timelines and milestones, by June 1, 2023.

Thank you for the audit. We find the results valuable and will continue our work within the climate-related financial risk sphere.

cc: Anju Vajja
Kait Hildner
Jessica Shui
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Varun Joshi

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