The Fed - Climate Change and the Role of Regulatory Capital A Stylized Framework for Policy Assessment

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This paper presents a stylized, non-country-specific framework to assess conceptually how the financial risks of climate change could interact with a regulatory capital regime. We summarize core features of a capital regime such as expected and unexpected losses, regulatory ratios and risk-weighted assets, and minimum requirements and buffers, and then consider where climate-related risk drivers may be relevant. We show that when considering policy implications, it is critically important to be precise about how climate change may impact the loss-generating process for banks and to be clear about the specific policy objective. While climate change could potentially impact the regulatory capital regime in several ways, an internally coherent approach requires a strong link between specific assumptions and beliefs about how these financial risks may manifest as bank losses and what objectives regulators are pursuing. We conclude by identifying several potential research opportunities to better understand these complex issues and inform policy development.

**Url:**<https://www.federalreserve.gov/econres/feds/climate-change-and-the-role-of-regulatory-capital.htm>