The Institute of
Internal Auditors
Elevating Impact

February 10, 2022

Via Online

Re: Docket ID OCC-2021-0023

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th St. SW, Suite 3E-218
Washington, DC 20219

Dear Sir/Madam:

On behalf of The Institute of Internal Auditors (The IIA) and our more than 210,000 professional members worldwide, I thank you for the opportunity to comment on OCC's *Principles for Climate-Related Financial Risk Management for Large Banks*. The IIA believes it is essential to include an independent internal audit function – the third line in The IIA's *Three Lines Model* – to provide the necessary independent, internal assurance to boards, management, investors, and stakeholders around climate-related risks and disclosures, as well as related Environmental, Social and Governance (ESG) information. This builds trust and confidence in this information, similar to how it already does for financial disclosures. ESG information, including climate disclosures, is rapidly becoming a key determinant of value for all types of organizations – banks included. However, this type of information currently lacks the same level of trust as that of financial information among providers of capital as well as regulators and other key stakeholders.

The internal audit function provides the objective internal assurance, independent of management, needed to build confidence in ESG- and climate-related risk and disclosure information, well before that provided by external auditors. Global sustainability standards will likely be offered as early as 2022 by the newly formed International Sustainability Standards Board, an independent board that sits alongside the International Accounting Standards Board at the IFRS Foundation. The internal audit function will test the effectiveness of controls around risk management and the information disclosed according to these standards, and imbue it with the trust needed to assess risk, inform business strategy, and grow value. Banks will disclose their climate-related risk information utilizing these standards – an independent internal audit function will provide the assurance on that information needed by boards, management, investors, and stakeholders. The IIA recommends that the OCC consider this in its *Principles for Climate-Related Financial Risk Management for Large Banks.*

In addition to existing OCC rules and guidance, the internal audit profession has received widespread identification and recognition as an important player in the foundation for the safe and sound operation of financial institutions, as summarized below. It is vital that this recognition of the independent internal audit function continue in the management and disclosure of climate-related financial risks.

- As part of Section 39 of the Federal Deposit Insurance Act, requiring each Federal banking agency to establish certain safety and soundness standards, the agencies must establish operational and managerial standards relating to internal audit systems with provisions including adequate monitoring of the system of internal controls through an internal audit function, as well as independence, objectivity, and qualification of the internal audit function.

- World Bank Group member International Finance Corporation's corporate governance progression matrix includes the internal audit function in its six key corporate governance parameters. Its recently published ESG Guidebook recommends tasking internal audit with assessing the soundness of the company's management system. Its ESG

Guidebook also recommends that the set of disclosures includes internal audit responsibilities and reporting lines, as well as the governance and independence of the function.

- The Basel Committee on Banking Supervision states that an independent, competent, and qualified internal audit function is vital to the corporate governance process. Basel's existing principles for enhancing corporate governance and guidance for assessing the effectiveness of the internal audit function already identify and value the role of an organization's internal audit function. Basel's principles also highlight that an organization can enhance the ability of its internal audit function by having internal auditors adhere to national and international professional standards, such as the International Professional Practices Framework established by The Institute of Internal Auditors.

- The 2022 Ceres *Guidance for Engaging on Climate Risk Governance and Voting on Directors* outlines its guidance based on the Task Force on Climate-related Financial Disclosures. Included in this guidance is that audit committees should direct the company's internal audit department to include, in their respective work scopes, sufficient testing of the impacts of climate change risk on the company's operations.

The Three Lines Model
The widely accepted Three Lines Model, updated and published by The IIA in 2020, articulates the core components of effective governance, emphasizing the need for clear roles and responsibilities toward confronting applicable risks, and the crucial importance of effective coordination, communication, and collaboration. Because of its holistic view and understanding of risks across an organization, internal audit is uniquely positioned to provide objective assurance, independent from management, on effective governance structures and systems of internal control (such as those using the *COSO Internal Controls - Integrated Framework to* manage climate-related financial risks). This assurance, in turn, ensures complete, accurate, and reliable climate-related information, including public disclosures, on which to effectively assess risk, systemic or otherwise, and protect the safety and soundness of the U.S. financial services sector.

Sarbanes–Oxley Act of 2002
Following the Sarbanes-Oxley Act of 2002, OCC issued in March 2003 the *Interagency Policy Statement on the Internal Audit Function and its Outsourcing*. The policy statement highlighted that directors and senior management should not rely too much on management self-assessments alone, and that institutions generally should also have their internal controls tested and evaluated by units without business-line responsibilities, such as internal audit groups whose activities are conducted in accordance with professional standards (The IIA's *International Standards for the Professional Practice of Internal Auditing* are the only global standards for the profession). The policy statement further confirmed the importance of the internal audit function's independence by recommending the ideal organizational arrangement of the internal audit manager reporting directly and solely to the audit committee regarding both audit issues and administrative matters.

OCC Request for Feedback – The IIA's Responses
The attached Annex A details our specifc comments on *Principles for Climate-Related Financial Risk Management for Large Banks*, summarized as follows:

- Highlight the importance of assurance as an integral part of effective governance and risk management.
- Identify the internal audit function as the third key player, in addition to the board and management, in a bank's three lines of effective governance and risk management.
- In alignment with OCC's *Interagency Policy Statement on the Internal Audit Function and its Outsourcing* that "directors and senior management should not rely too much on management self-assessments alone," banks should use objective assurance, independent of management, provided by the bank's internal audit function.
- Banks should seek independent assurance from the bank's internal audit function to ensure that any public statements about their banks' climate-related strategies and commitments are consistent with their internal strategies and risk appetite statements.
- Because of internal audit's holistic view and understanding of risks throughout the organization, the bank's internal audit function should be identified as a key stakeholder that provides input into the risk identification process.
- Validation, provided by the bank's independent internal audit function, should be a key attribute of quality data.
- Internal audit functions should ensure they are considering and incorporating climate-related risks as part of their independent assessment of a bank's risk assessment as well as their own internal audit planning process.

Thank you for the opportunity to provide feedback on the OCC's *Principles for Climate-Related Financial Risk Management for Large Banks*. I encourage the OCC to continue to identify and recognize the value of internal assurance, independent from management, provided by a bank's internal audit function over the management and disclosure of any material risk, including those that are climate and ESG related. The IIA stands ready to assist as the OCC develops any future guidance affecting the management, control, and disclosure of climate-related financial risks. I am available to discuss our response with you at your convenience.

Sincerely,

Anthony J. Pugliese, CIA, CPA, CGMA, CITP
President and Chief Executive Officer
The Institute of Internal Auditors, Global Headquarters

Annex A

OCC Request for Feedback – The IIA's Responses

The Institute of Internal Auditors (The IIA), with its more than 210,000 professional members worldwide, offers the following feedback on the OCC's *Principles for Climate-Related Financial Risk Management for Large Banks:*

"Introduction"
This section discusses the potential for weaknesses in a bank's risk management and control of climate-related financial risks and the potential adverse effects on the safety and soundness of a bank. Key to any risk management framework is independent internal assurance. As such, The IIA recommends the following changes to the language:

- **Second paragraph:** *"Weaknesses in how banks identify, measure, monitor, ~~and~~ control and assure the potential physical and transition risks associated with a changing climate could adversely affect a bank's safety and soundness, as well as the overall financial system."*

Additionally, the last paragraph discusses roles and responsibilities of two of the three lines. As stated in The IIA's newly updated (2020) *Three Lines Model*, the third key role in effective governance, in addition to the governing body and management, is independent internal assurance provided by an internal audit function operating in conformance with the *International Standards for the Professional Practice of Internal Auditing*. As such, The IIA recommends the following changes to the language:

- **Last paragraph:** *"The OCC plans to elaborate on these principles in subsequent guidance that would distinguish roles and responsibilities of a bank's three lines (boards of directors (boards), ~~and~~ management and internal audit), incorporate the feedback received on the principles, and consider lessons learned and best practices from the industry and other jurisdictions."*

"General Principles: Governance"
The "Governance" section of "General Principles" discusses the roles and responsibilities of the board and management relative to the management, mitigation, and control of climate-related risks, yet fails to mention the central role of a bank's independent internal audit function. It indicates that bank management is responsible for regularly reporting to the board on the level and nature of risks to the bank that could be in conflict with the OCC's *Interagency Policy Statement on the Internal Audit Function and its Outsourcing,* which indicates that directors and senior management should *not* rely too much on management self-assessments alone. Therefore, The IIA recommends adding a sentence at the end of the second paragraph of the "Governance" section of the "General Principles":

- **Added sentence, end of second paragraph:** *"Boards should require that the bank's internal audit function independently test the effectiveness of controls and review management's reporting and disclosures on climate-related risks. Boards should rely on this objective assurance, provided independent of management by the bank's internal audit function, to exercise its duty of overseeing climate-related financial risks."*

"General Principles: Strategic Planning"
The "Strategic Planning" section of "General Principles" discusses the alignment of risk management with a bank's strategy. It further notes that a bank should ensure that any public statements about climate-related strategies are aligned with internal strategies and risk appetite. The section fails to suggest how a bank can provide this internal assurance. The IIA recommends modifying the last sentence of the final paragraph of the "Strategic Planning" section of the "General Principles":

- **Final paragraph:** *"In addition, where banks engage in public communication of their climate-related strategies, boards and management should seek independent assurance from the bank's internal audit function to ensure that any public statements about their banks' climate-related strategies and commitments are consistent with their internal strategies and risk appetite statements."*

GLOBAL HEADQUARTERS | 1035 Greenwood Blvd., Suite 149 | Lake Mary, FL 32746 USA | Phone: +1-407-937-1111

"General Principles: Risk Management"

The "Risk Management" section of "General Principles" discusses a bank's enterprise risk management framework, including seeking input from key stakeholders, but fails to identify the independent internal audit function as one of these key stakeholders. Because of its holistic view and understanding of risks throughout the bank, internal audit is uniquely positioned to provide this input. The IIA recommends the following changes to the "Risk Management" section of the "General Principles":

- **First paragraph:** *"The risk identification process should include input from stakeholders across the organization with relevant expertise (e.g., business units, independent risk management, ~~and~~ legal, and internal audit). Risk identification includes assessment of climate-related financial risks across a range of plausible scenarios and under various time horizons."*

- **Added sentence, end of second paragraph:** *"Banks should engage their internal audit function to provide objective assurance, independent of management, on the effectiveness of the overall risk management framework."*

"General Principles: Data, Risk Measurement, and Reporting"

The "Data, Risk Measurement, and Reporting" section of "General Principles" highlights the importance of quality data as a basis for sound decision-making, yet it fails to include some key attributes of quality data. In addition, assurance should be identified as a key capability. The IIA recommends the following changes to the "Data, Risk Measurement, and Reporting" section of the "General Principles":

- *"Sound climate risk management depends on the availability of relevant, accurate, ~~and~~ timely, complete, and valid data. Management should incorporate climate-related financial risk information into the bank's internal reporting, monitoring, and escalation processes to facilitate timely and sound decision-making across the bank. Effective risk data aggregation, validation, analysis, and reporting capabilities allow management to capture and report material and emerging climate-related financial risk exposures, segmented or stratified by physical and transition risks, based upon the complexity and types of exposures. Data, risk measurement, modeling methodologies, and reporting continue to evolve at a rapid pace; management and internal audit should monitor these developments and incorporate them into their climate risk management and assurance as warranted."*

"General Principles: Management of Risk Areas"

The "Management of Risk Areas" section of "General Principles" discusses the risk assessment process, including the identification of emerging risks. A bank's independent internal audit function serves a key independent role in governance, risk management, and control and, as such, should be identified as a key role within this section. Internal audit managers should ensure they are considering and incorporating climate-related risks as part of their independent assessment of a bank's risk assessment as well as their own internal audit planning process. The IIA recommends the following change to the "Management of Risk Areas" section of the "General Principles":

- *"A risk assessment process is part of a sound risk governance framework, and allows boards and management to identify emerging risks and to develop and implement appropriate strategies to mitigate those risks. Boards, ~~and~~ management, and internal audit should consider and incorporate climate-related financial risks when identifying, assessing, and mitigating all types of risk. These risk assessment principles describe how climate-related financial risks can be addressed in various risk categories. The OCC will elaborate on these risk assessment principles in subsequent guidance."*