Climate risk regulatory developments in financial services

Leading off

The Biden administration’s recent executive order on climate-related financial risks reinforces the trend of climate risks gravitating to the center of the US financial agencies’ regulatory agenda. While many steps remain to implement the actions outlined in the executive order, it has the potential to affect businesses across the global economy, especially financial services firms.

Recently before both houses of Congress, the chief executive officers (CEOs) of the six major US banks discussed the increased financial and reputational risks in financing fossil fuel industries. Each of the six major banks has made its own climate commitments for 2050, aligning its financing with a core goal of the Paris Climate Agreement. All six plans include significant sustainable finance commitments, focusing at least partly on the physical and transition risks from climate change for their clients.

Additionally, G7 leaders in early June announced their commitment to mandatory climate-related financial disclosures, modeled on those recommended by the G20’s Task Force on Climate-Related Financial Disclosures (TCFD). This global approach provides a road map for integrating climate risk metrics in corporate governance and strategy.

Biden administration issues an executive order on climate-related financial risks

On May 20, 2021, the White House issued an executive order encouraging disclosure of climate-related financial risks, promoting job creation and social and economic justice goals, reaching net-zero emissions targets by 2050, and positioning the United States to continue leading the global economy.

The executive order reinforces the Biden administration’s call for a whole-of-government approach to addressing climate-related financial risk, but does not set forth any specific policies that financial regulatory agencies must implement. Rather, it strengthens an already prominent role for US Treasury Secretary Janet Yellen as the Financial Stability Oversight Council (FSOC) chair in steering a coordinated financial
regulatory agenda. The executive order suggests that the FSOC member agencies issue a report to President Biden within 180 days outlining actions they are taking to reduce climate-related risks, including efforts to enhance disclosures and changes to their supervisory activities.

“The failure of financial institutions to appropriately and adequately account for and measure these physical and transition risks threatens the competitiveness of US companies and markets, the life savings and pensions of US workers and families, and the ability of US financial institutions to serve communities.”

– Executive Order on Climate-Related Financial Risk, May 2021

It instructs Secretary Yellen to direct the Office of Financial Research to provide data collection and research development to FSOC on climate-related financial risks. It also directs the Federal Insurance Office (FIO) to analyze the climate matters pertaining to the insurance sector, including threats of disrupting private insurance coverage in vulnerable regions. FIO will have a new and emerging role as coordinator at an international and domestic level to assess climate-related issues or gaps in the supervision and regulation of insurers, including as part of the FSOC’s analysis of financial stability.

It also directs the US Secretary of Labor to identify actions that can be taken under the Federal Employees’ Retirement Systems Act (known as ERISA) of 1986 and other laws to protect US workers’ life savings and pensions from climate-related financial risk. The Department of Labor (DOL) had already announced that it intends to revisit the prior administration’s rules that discouraged investment decisions based on environmental, social, and governance (ESG) issues and not enforce those rules until it published further guidance. The DOL had already announced that it intends to revisit the prior administration’s rules that discouraged investment decisions based on ESG issues and not enforce those rules until it published further guidance.

Key takeaways

A growing number of financial firms are focusing their capabilities and approaches to organize internally, understand how to monitor progress to meet targets, and assess how to quantify and report financed emissions (based on Paris Agreement Capital Transition Assessment (PACTA) methodology).

The insurance industry is known for not having a consolidated regulator, but instead having many regulatory voices. The insurance industry is known for not having a consolidated regulator, but instead having many regulatory voices. US insurers, for example, are state-regulated, although regulatory standards are often coordinated nationwide through the National Association of Insurance Commissioners. With the growing volume of new regulatory developments, the US insurance industry appears to be playing catch-up with the broader financial services industry. In addition, President Biden’s executive order has the potential to reinvigorate the role of the FIO to serve as a domestic and global coordinator on climate-related policies and to assess gaps in the supervision and regulation of US insurers. In addition, the executive order has reinvigorated the role of the FIO to serve as a domestic and global coordinator on climate-related policies and to assess gaps in the supervision and regulation of insurers.

Other notable US regulatory developments

• The Network for Greening the Financial System (NGFS). On June 9, 2021, NGFS released an updated version of its climate scenarios for central banks and supervisors. The set of six potential climatic and transition pathways offers much more detail than the initial iteration, published in 2020. They include impact mapping by country, along with nearly 1,000 economic, financial, transition, and physical variables. The NGFS climate scenarios were developed in partnership with a wide academic consortium using a range of climatic, transition, and economic models. The network will now focus on their application in central bank case studies and work with industry to ensure the scenarios are suitable for wider use. A further update is expected in spring 2022.

• New York Department of Financial Services (NYDFS) issues a new report analyzing New York domestic insurers’ exposure to the financial risks of society’s transition toward a low-carbon economy. The June 2021 NYDFS report, written in collaboration with the 2° Investing Initiative (2DII), an independent, nonprofit think tank helping to align the financial sector with international climate goals, furthers the agency’s recent efforts to support insurers managing the financial risks from climate change. NYDFS noted that, across the financial services industry, “the impact of climate change on insurers’ investments receives less attention than the impact of climate change on insurers’ liabilities, and low-carbon transition risks are less understood than climate-related physical risks.” 2DII analyzed the transition risks of New York domestic insurers by assessing the alignment of their equity and corporate bond portfolios using their 2019 Schedule D data against different climate scenarios. 2DII’s analysis covered 250 insurance companies with portfolios worth more than $550 billion. The report found that New York domestic insurers’ investments had meaningful exposure to carbon-intensive sectors. Additionally, it found that life insurers generally had greater exposure to carbon-intensive sectors than P&C and health insurers. The report follows on the heels of US insurance firms submitting a report aligned with TCFD recommendations.

• NGFS publishes a progress report with preliminary findings on bridging climate-related data gaps. On May 26, 2021, NGFS released a report titled Progress report on bridging data gaps, which forms part of the first phase of the NGFS workstream on bridging climate-related data gaps. The report finds that reliable and comparable climate-related data is indeed crucial for financial sector stakeholders to
assess financial stability risks, properly price and manage climate-related risks, and take advantage of the opportunities arising from the transition to a low-carbon economy. However, persistent gaps in climate-related data hinder the achievement of these objectives. Stakeholders involved in the NFPS report stated the need for more forward-looking data (e.g., targets or emissions pathways) and granular data (e.g., geographical data at entity and asset levels). They are also calling for assurance about the quality of climate-related disclosure data through verification and audit mechanisms and improvements in data accessibility.

• **CEOs of the six major US banks testify before both houses of Congress on a range of topics, including their efforts to prepare for and manage climate risks.** On May 26 and 27, 2021, the CEOs of the US global systemically important banks appeared before Congress to testify on their banks’ activities during the COVID-19 pandemic and to provide an update on the various policy matters. The CEOs discussed the idea of a carbon tax, a standardized climate risk disclosure framework, climate transition plans, and potential decarbonization and debanking of certain industries.

• **US Securities and Exchange Commission (SEC) Commissioner Allison Lee speaks on 2021 ESG disclosure priorities.** In a May 24, 2021, speech hosted by the American Institute of Certified Public Accountants, SEC Commissioner Allison Lee addressed several myths and misconceptions about the concept of “materiality,” arguing that “securities laws currently include little in the way of explicit climate or other sustainability disclosure requirements.” Because of this, “climate and ESG information important to a reasonable investor is not necessarily required to be disclosed simply because it is material.” Commissioner Lee hopes “to dispense with these misnomers as [the agency] continue[s] the important debate on how best to craft a rule proposal on climate and ESG risks and opportunities.” The SEC has issued a recent flurry of notices and other activities that such disclosures will be prioritized this year. The comment period just closed on the SEC’s call for preliminary input on how companies should disclose climate-relevant information in filings with regulators.

• **Acting Office of the Comptroller of the Currency (OCC) Comptroller Michael Hsu signals OCC’s interest in joining NGFS.** On May 19, 2021, the House Financial Services Committee (HFSC) held its semiannual oversight hearing of the US banking regulators. In his testimony, Acting Comptroller Michael Hsu said the OCC is pursuing a two-pronged approach to engage with and learn from other federal and international supervisors and support developing and adopting effective climate risk management practices at banks. Under his leadership, Hsu said the OCC will consider joining the NGFS, will be active participants in international standard-setting bodies, and will ensure the agency “acts with a sense of urgency” on climate risks. The OCC also highlighted climate risks in its Semiannual Risk Perspective, released in May 2021.

• **Federal Deposit Insurance Corporation (FDIC) Chairman Jelena McWilliams says the agency is concerned about the climate-related risks for agricultural lending as part of the broader US banking system.** In the HFSC hearing, a member of Congress asked FDIC Chairman McWilliams if the agency had the proper tools to assess climate risks to the financial performance of banks they supervise. Chairman McWilliams said the agency expects banks to factor in climate risks in their operating environment; ensure that banks and borrowers have appropriate insurance coverage; adjust cash flow estimates based on reduced agricultural yields for adverse business conditions; and comply with applicable regulations rules, regulations, and building codes. Her testimony notes that several FDIC Regional Risk Committees include environmental factors in their regular analysis of changing conditions in the banking system, such as drought in western states.

**Global regulatory highlights**

• **United Kingdom announces new independent group to tackle greenwashing.** On June 9, 2021, Her Majesty's Treasury (HM Treasury) announced creating a new independent group, the Green Technical Advisory Group (GTAG). The GTAG will provide independent, nonbinding advice to the government on developing and implementing a green taxonomy in the UK context. The green taxonomy is intended to clamp down on greenwashing (unsubstantiated claims about investments being environmentally friendly) and assist investors and consumers in understanding how firms’ decisions affect the environment. The GTAG will be chaired by the Green Financial Institute, made up of financial and business stakeholders; taxonomy, policy, and data experts; and the Environment Agency and the Committee on Climate Change. HM Treasury, the Financial Conduct Authority, the Bank of England (BoE), and other relevant government departments and regulators will be observers to GTAG.

• **BoE publishes the key elements of the 2021 Climate Biennial Exploratory Scenario (CBES).** On June 8, 2021, the BoE announced that the CBES will assess the exposure of the largest UK banks and insurers to climate-related risks. The CBES uses three scenarios (early action, late action, and no additional action) to assess the financial risks associated with different potential climate outcomes. The scenarios are based on those set by the Network for Greening the Financial System. The exercise will not be used to assess firms’ financial resilience to climate-related risks or to set capital requirements. Firms will be required to undertake granular counterparty-level analysis of their most significant counterparties (at least the firm’s top 100 largest and most material corporate counterparties where exposures are more than £10 million). The results of the exercise will be published in May 2022.

• **Taskforce on Nature-related Financial Disclosures (TNFD) launches to give financial institutions and companies...**
a complete picture of their environmental risks. A new global initiative, the TNFD, launched on June 4, 2021, and has earned international political support through endorsement by G7 Finance Ministers. It will complement climate finance by emulating existing recommendations on climate-related risk disclosures from the TCFD and will recommend new exposures for financial services firms and corporations that capture nature-related risks from 2023. The goal of the TNFD is to provide a framework for organizations to report on threats from biodiversity loss and ecosystem degradation. In turn, improving the availability of data and information will enable organizations to integrate nature-related risks more accurately and reliably into decision-making.

Additional Deloitte perspective on climate risks

For additional insight, please see our ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy.

- Deloitte Insights: “Centering around sustainability in financial services firms: Navigating risks, finding opportunities”
- Deloitte’s monthly Creating a climate of change digest: Climate risk regulatory developments in financial services
- Global foreword to 2021 financial markets regulatory outlook, highlighting climate risks in FSI
- US climate risk
- 2021 UK/EU financial markets regulatory outlook on sustainability
Creating a climate of change digest: Climate risk regulatory developments in financial services

Endnotes

3. Ibid.
6. For additional analysis, please see our prior Creating a climate of change digest, released on June 7, 2021.
8. The open-source Paris Agreement Capital Transition Assessment (PACTA) model is used by more than 3,000 financial institutions, governments, supervisory authorities, and industry associations.
9. Please note: The US and global regulatory developments highlighted in the newsletter are not exhaustive of all activities occurring between mid-May and mid-June 2021, but rather a representative sample of them.
12. Ibid.
16. Ibid.
18. See May Deloitte newsletter.
22. Ibid.
25. FDIC, “Jelena McWilliams testimony before the Committee on Financial Services US House of Representatives.”
26. Please note: the US and global regulatory developments highlighted in the newsletter are not exhaustive of all activities occurring between mid-May and mid-June 2021, but rather a representative sample of them.