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Creating a climate of change digest

Climate risk regulatory developments in the financial services industry

Leading off

On March 19, 2024, the US Department of the Treasury (Treasury) hosted a virtual roundtable with insurance industry stakeholders to discuss how the increased risks from climate change are affecting US insurance markets.[1]

The Under Secretary for Domestic Finance, and other senior Treasury officials, initiated discussions with insurers, reinsurers, and catastrophe modeling firms regarding challenges that climate change poses to the US insurance industry and to American households. The discussion also revolved around the regulatory and policy responses that states and localities are undertaking to address these challenges and the potential market responses.

The event was conducted in support of President Biden's Executive Order 14030, which leverages a government-wide approach to addressing climate-related financial risk. Among other directives, Executive Order 14030 instructs the Federal Insurance Office (FIO) to "assess climate-related issues or gaps in the supervision and regulation of insurers, including as part of the Financial Stability Oversight Council's (FSOC's) analysis of financial stability, and to further assess, in consultation with States, the potential for major disruptions of private insurance coverage in regions of the country particularly vulnerable to climate change impacts."[2]

The roundtable discussion follows the launch of the FIO's collaboration with state insurance regulators and the National Association of Insurance Commissioners (NAIC) to collect ZIP code-level insurance data to better understand the impacts of climate-related financial risks on the insurance industry[3] as well as Treasury's roundtable with consumer and climate groups in February.[4]

The US Treasury Department and Internal Revenue Service (IRS) released further guidance concerning the energy community bonus allocation under the Inflation Reduction Act (IRA) for clean energy projects on March 22, 2024.[5]

The IRA had amended sections 45 and 48 of the Internal Revenue Code[6] to provide increased credit amounts or rates if certain requirements pertaining to energy communities are satisfied, and added new sections 45Y and 48E to provide increased credit amounts or rates for certain qualified facilities, energy projects, or energy storage technologies that satisfy similar requirements and that are placed in service after December 31, 2024.

The bonus credit aims to stimulate investment in communities historically associated with energy production and, as a result, seeks to boost job creation in the clean energy sector and reduce energy costs. Developers can qualify to receive a bonus credit of up to 10% on top of the investment tax credit (ITC) and a 10% increase for the production tax credit (PTC). The bonus for ITC and PTC is available for developers locating projects in areas historically reliant on fossil fuels for employment, wages, or tax revenue.

The guidance released in March 2024, Notice 2024-30,[7] modifies the guidance previously set forth in Notice 2023-29.[8]

1. Expansion of the Nameplate Capacity Attribution Rule to include additional attribution property.
2. Addition of two 2017 North American Industry Classification System (NAICS) industry codes for purposes of determining the fossil fuel employment rate.

The updated guidance includes additional NAICS codes, 2212 (Natural Gas Distribution) and 23712 (Oil and Gas Pipeline and Related Structures Construction), in the definition of "fossil fuel employment." The inclusion of these codes expands the list of Metropolitan and non-Metropolitan Statistical Areas (MSAs and non-MSAs) that qualify as energy communities.

Significantly, the revised guidelines now permit offshore wind facilities to attribute their nameplate capacity to supervisory control and data acquisition system (SCADA) equipment located in eligible ports. This change is intended to acknowledge the importance of onshore SCADA equipment to offshore wind projects and the job creation potential in these ports. Additionally, the guidance clarifies the determination of energy community status for projects with multiple interconnection points.

The IRS will also provide additional clarity on brownfields' eligibility through a series of frequently asked questions. This new guidance is expected to provide the necessary clarity to companies planning investments in these energy communities.

The Securities and Exchange Commission (SEC) has issued an order staying the implementation of its Final Rule on Climate-Related Disclosures for Investors.[9]

The Final Rule[10] requiring registrants to provide certain climate-related information in their registration statements and annual reports was promulgated on March 6, 2024. However, petitions seeking review of the Final Rules were filed in multiple courts of appeals between March 6 and March 14, 2024.

The SEC requested consolidation of the petitions in a single court of appeals. On March 21, 2024, the United States Judicial Panel on Multidistrict Litigation, by lottery, selected the United States Court of Appeals for the Eighth Circuit as the venue to consolidate the multicircuit petitions against the Rule, for review.[11]

The SEC filed a motion to establish a consolidated briefing schedule encompassing all motions seeking a stay of the Final Rules on March 29, 2024. Thirty-one petitioners opposed the SEC's motion and urged the Court to expedite briefing on the emergency stay motions.

The SEC then exercised its discretion to stay the Final Rules pending the completion of judicial review of the consolidated Eighth Circuit petitions.[12] The stay is not intended to indicate a departure from the view that the Final Rules are consistent with applicable law and within its authority to require disclosure of information important to investors. The SEC continues to defend the Final Rules' validity in court in hopes for a swift resolution of the litigation. The stay has been exercised to facilitate the orderly judicial resolution of the challenges to the Final Rules and to avoid potential regulatory uncertainty for registrants.

The Science Based Targets initiative (SBTi) revises Corporate Net-Zero Standard, expanding use of environmental attribute certificates (EACs) like carbon credits to address scope 3 emissions. It seeks to define rules for EAC validity and foster collaboration for responsible usage, aiming to accelerate value chain decarbonization amid growing emissions gaps.[13]

In January 2024, the SBTi announced its intent to revise the Corporate Net-Zero Standard, prioritizing the inclusion of additional guidance on addressing scope 3 emissions. As part of this effort, SBTi has begun exploring the use of EACs for the purpose of abatement of scope 3 emissions, with the caveat that such would be defined with specific rules, guardrails, and thresholds.

While this represents a shift in SBTi's approach, the organization has indicated that it will ground these new measures in scientific evidence and established standards, aiming to mitigate climate risks effectively. To shape this framework, SBTi intends to collaborate with a range of stakeholders and related initiatives, promoting responsible certificate usage in target setting.

The framework will include transparent rules and thresholds for using EACs in corporate climate action. However, SBTi has stated it will not directly handle the validation of carbon credits, leaving this to specialized entities. Instead, SBTi plans to focus on establishing guardrails and providing clearer guidance for those entities that validate these certificates.

As part of the revision process, SBTi intends to issue a draft of basic rules, thresholds, and guardrails by July 2024, providing stakeholders with early insights into the forthcoming standards. Despite these proactive measures, uncertainties remain regarding the types of credits that will be accepted, the portion of scope 3 emissions eligible for abatement, timelines for implementation, and engagement requirements for companies.

The fourth edition of the Target-Setting Protocol by the Net-Zero Asset Owner Alliance (Alliance) reaffirms the aim of achieving a 1.5°C target for portfolios by 2030, signaling a forward-looking stance amid evolving real-world progress.[14]

The Alliance has unveiled its fourth edition of the Target-Setting Protocol, designed to guide institutional investors in reducing portfolio emissions over the next five years. This edition encompasses a wide array of asset classes, such as private debt funds and real estate debt. The initiative has garnered commitment from 89 institutional investors.

The protocol sets targets for its members, aiming for a 40% to 60% reduction in greenhouse gas emissions by 2030 compared to 2019 levels, aligning with the Intergovernmental Panel on Climate Change (IPCC) Sixth Assessment Report estimates and the goal of limiting global warming to 1.5°C.

The protocol introduces new "2030 targets," requiring members to set five-year emissions reduction goals covering the period 2025–2030. Members are required to publish targets within 12 months of joining, disclose progress annually, report to the Alliance using specified templates, and engage in the Alliance reporting cycle.

In addition to targeting emissions reductions, the Alliance is piloting the assessment of sovereign debt holdings. It provides guidelines on debt reporting including the scope of emissions to be reported, the accounting approach to be used, and key metrics to evaluate emissions.

The protocol also reaffirms the Alliance's stance on carbon removals, prioritizing emissions reductions over carbon removal for achieving decarbonization targets. It emphasizes the importance of a well-regulated carbon removal certificate market and encourages investments in projects and technologies that facilitate durable carbon avoidance and removal.

To support its members in developing credible transition plans, the Alliance provides tools and resources, including a background document and its paper, *Understanding the drivers of investment portfolio decarbonisation*.

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Additional Deloitte US perspective on climate risks

For additional insights, 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:

- 2024 financial services industry outlooks
- *Deloitte 2023 CxO Sustainability Report*
- Ingraining sustainability in the next era of ESG investing
- The CIO’s call to action: Driving an environmentally sustainable tech agenda to accelerate organizational change
- Climate change and financial risk digest | Deloitte US
- Center for Regulatory Strategy - Sustainability, climate & equity | Deloitte US

Endnotes

1. The US Department of the Treasury (Treasury), "U.S. Department of the Treasury hosts roundtable with insurance industry stakeholders on climate-related risks and U.S. insurance markets," press release, March 19, 2024.
2. Joseph R. Biden, "Executive Order on Climate-Related Financial Risk," The White House, May 20, 2021.
3. Treasury, "U.S. Department of the Treasury and state insurance regulators launch coordinated effort on homeowners insurance data collection to assess the effects of climate risk on U.S. insurance markets," press release, March 8, 2024.
4. Treasury, "U.S. Department of the Treasury hosts roundtable with consumer and climate groups on climate-related risks and U.S. insurance markets," press release, February 26, 2024.
5. Treasury, "Treasury releases additional guidance to drive investment to energy communities as part of President Biden's Investing in America agenda," press release, March 22, 2024.
6. United States Code, "*Title 26—Internal Revenue Code*," accessed May 2024.
7. Internal Revenue Service (IRS), "*Notice 2024-30*," March 2024.
8. IRS, "*Notice 2023-29*," April 2023.
9. Securities and Exchange Commission (SEC), "*The SEC has issued a stay on its final rules*," April 4, 2024.
10. SEC, "*Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors*," March 21, 2024.
11. United States Judicial Panel, "*MCP No. 180 Consolidation Order*," March 2024.
12. Ibid.
13. Science Based Targets initiative (SBTi), "SBTi revises Corporate Net-Zero Standard, expanding use of EACs," April 9, 2024.
14. United Nations Environment Programme Finance Initiative, "UN-convened Net-Zero Asset Owner Alliance released its fourth edition of the Target-Setting Protocol," April 18, 2024.