Creating a climate of change digest: Climate risk regulatory developments in financial services

**Leading off**

Until recently, climate risk has received significantly more interest from United Kingdom (UK) and European Union (EU) financial institutions and regulators than from their United States (US) counterparts. Over the past several months, however, there has been a steady increase in US regulatory and supervisory activities to monitor climate risks and assess their impact on global financial stability, accompanied by growing climate awareness among leading US financial institutions. In an annual letter to CEOs, BlackRock’s Chairman and CEO Larry Fink urged all companies to assess sustainability risks and disclose a plan for how their business models will be compatible with a net-zero economy “rather than waiting for regulators to impose them.”

The sustainability agenda will likely continue, accelerating change for financial services in the US with a new administration, Congress, and regulatory leadership. Each month, we’ll be offering a closer look at some of the biggest regulatory trends we see shaping the management of climate risks in financial services, now and in the coming decade. We look forward to convening a dialogue with you on these important developments and their broader impact.

**The current landscape**

On pause: The Office of the Comptroller of the Currency’s (OCC) proposed rule to ensure fair access to the banking system reflects the ongoing discussion over the proper role of incorporating environmental, social, and governance (ESG) principles in capital allocation and corporate decision-making.

To begin this month’s perspective, we are highlighting the rapidly evolving debate and rulemaking process following the OCC’s proposed rule to ensure fair access to the banking system, which—in less than two months—went from proposal to comment period to finalized rule, only to be paused in the Federal Register on January 28, 2021.
In November 2020, the OCC sought to codify “more than a decade of OCC guidance stating that banks should conduct risk assessments of individual customers, rather than make broad-based decisions affecting whole categories or classes of customers, when providing access to services, capital, and credit.”

The OCC’s proposal would have applied to “covered banks,” defined as OCC-regulated financial institutions with more than $100 billion in total assets. The regulation would have prohibited these banks from denying financial services to any firm or customer without a “documented failure to meet quantitative, risk-based standards.”

Some observers considered the agency’s actions to be, in part, a reaction to several recent instances of large banks denying lending to the energy industry (e.g., major oil, gas, and coal projects) as momentum builds in the US for a transition toward a low-carbon economy. The proposal referenced several climate-related financial developments and connected these examples to other industries and sectors that have been “debanked” in recent years, such as family planning organizations, privately owned correctional facilities, and firearms manufacturers.

The OCC received more than 35,000 comments in its nearly one-month public comment period, during which lenders, investors, consumer groups, and some Congressional members of both political parties criticized the rule. The rule was finalized in mid-January, shortly before then-acting Comptroller of the Currency Brian Brooks resigned from office. On January 28, 2020, the OCC announced it had paused publication of the final rule to allow the next confirmed Comptroller of the Currency to review it. As of the date of this publication, the Biden administration has yet to name its nominee to head the agency.

Looking forward
The OCC’s proposed rule reflects the ongoing discussion over the proper role of incorporating ESG principles in capital allocation and corporate decision-making.

The comments highlighted the perceived tension for banks and other financial firms to navigate as they seek to manage societal expectations in diversifying and greening their portfolios while also remaining impartial and not intentionally disadvantaging specific markets or business segments. With the expectation that this type of financing will remain under scrutiny from clients and authorities alike, banks and financial firms will need to manage the associated reputational and regulatory risks.

It is worth noting that financial regulators themselves will need to navigate a similar tension during this period of industry and regulatory maturation as the US undergoes structural transition toward a low-carbon economy. A too-rapid push for “green” regulation from financial authorities ahead of the necessary alignment with broad public policy communities could have unforeseen, undesired outcomes.

Financial regulators understand that all institutions are unique and can be affected by climate risks differently, depending on their size, complexity, and geographic footprint. There is no one-size-fits-all approach for individual firms to address the inherent complexity and challenges that climate change poses. Still, there appears to be a path toward alignment on supervisory expectations globally, even as countries and companies move at different speeds to incorporate climate risks into their enterprise risk management and governance frameworks.

Other notable US regulatory developments

- Federal Reserve Board (FRB) creates a new leadership committee focused on supervising the banking system for financial risks posed by climate change. In January 2021, the FRB announced that Kevin Stroh, the head of the Supervision Group at the Federal Reserve Bank of New York (NY Fed), would lead the FRB’s supervisory work on climate-related financial risks and chair a newly formed Supervision Climate Committee (SCC). The SCC will play an important role in coordinating senior staff across the FRB and the Reserve Banks “to further build the Federal Reserve’s capacity to understand the potential implications of climate change for financial institutions, infrastructure, and markets.” In making the announcement, NY Fed President John Williams said, “[c]limate change has become one of the major challenges we face, which impacts all aspects of the Fed’s mission, and one that is having a devastating effect on communities around the world, particularly vulnerable populations.”

- The creation of the SCC is the latest in a series of efforts by the FRB to develop an approach for strengthening the financial system to meet the challenges posed by climate change. In December 2020, the FRB announced it had formally joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), a global research and coordinative body, after highlighting the risks to the financial system posed by climate change for the first time in its Financial Stability Report, published in November 2020.

- Together, these recent actions represent a potentially major shift toward global alignment on climate risk supervision, as the FRB seeks to elevate the priority of climate-related risk in its regulations and supervision and catch up with its central bank counterparts. However, the FRB may still choose to proceed in a cautious, methodical manner. The SCC will likely represent a forum for action over the long term as it weighs the balance of addressing a fairly new but growing risk to the banking system with the time needed to build the right approach and methods to become resilient.
"In the years ahead, there will be significant opportunities for collaboration across the US regulatory agencies in strengthening the US financial system to meet the challenge of climate change. Together, these efforts can help equip the deepest financial market in the world to support our dynamic private sector in assessing and addressing climate-related risks and investing in the transition.”

—Federal Reserve Board Governor Lael Brainard, December 2020

- Treasury Secretary Janet Yellen proposed new efforts by the Treasury to address climate risks in the financial system during her Senate confirmation hearing. Recently confirmed by a vote of 85-14, Secretary Yellen said she would create a “hub” within Treasury to review financial stability risks and seek tax policy incentives for addressing climate change.

- Yellen’s notion of a Treasury “hub” appears to be similar in design and function to the FRB’s SCC (discussed above), as well as the European Central Bank’s recently announced climate change center (discussed below). The creation of a climate “hub” follows earlier recommendations that House Financial Services Chairwoman Maxine Waters sent to the Biden administration to establish a Climate Change Working Group to coordinate policy at the Financial Stability Oversight Council (FSOC), which the Treasury Secretary chairs.

- Additionally, Waters recommended that the Treasury create a new Deputy Assistant Secretary position focused on international climate finance within the Office of International Affairs to strive toward global alignment on regulatory matters. In her Senate testimony, Yellen announced plans to appoint a “very senior-level” staff member to help lead the Treasury’s efforts. The Wall Street Journal recently reported that Sarah Bloom Raskin, a former deputy Treasury secretary and former Federal Reserve Governor, is seen as the leading candidate to head Treasury’s climate hub.

- A former Federal Reserve chair, Yellen said that labeling climate risk as a systemic risk "would convey a powerful message to the financial industry" and that both the impact of climate change itself and policies to address it could have major impacts, including creating stranded assets and generating large changes in asset prices and credit risks.

- The Securities and Exchange Commission (SEC) appointed a new senior policy advisor for Climate and ESG to advise Acting Chair Allison Herren Lee. The agency announced that Satyam Khanna, a former SEC and Treasury official, would oversee and coordinate the agency’s efforts related to climate risk and other ESG developments, which are “issues of great significance to investors and the capital markets.” In a similar vein, the House Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets announced it would soon hold a hearing on “Climate Change and Social Responsibility: Helping Corporate Boards and Investors Make Decisions for a Sustainable World.”

Selected highlights of global regulatory developments

- ECB creates a climate change center to coordinate activities ranging from monetary policy to prudential functions. In January 2021, the ECB announced it is creating a climate change center in recognition of the need for “a more structured approach to strategic planning and coordination” across the ECB as the central bank continues to address climate risk “with the urgency and determination that it deserves.”

- ECB mandates climate focus for supervisory stress tests in 2022 as part of its release on supervisory expectations. In November 2020, the ECB said it would focus its 2022 supervisory stress test on climate-related risks, with further details being provided throughout 2021. Alongside this announcement, the ECB released its final guide on climate-related and environmental risks and the expectations it has for “banks to prudently manage and transparently disclose such risks under current prudential rules.”

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.


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Endnotes

4. Ibid.
6. The OCC cites a June 2020 letter to US financial regulators from the Alaskan Congressional delegation on the decisions of several major financial institutions not to lend to new energy projects in the Arctic and the impact such refusal to lend could have on US national security, the US economy, and Native Alaskan communities.
9. Deloitte internal analysis of OCC comment letters and OCC summary of comments received.
10. OCC, "OCC Puts Hold on Fair Access Rule.”
11. These are selected highlights of recent regulatory announcements and developments, and not intended to be an exhaustive list.
13. Ibid.
14. Ibid.
15. Federal Reserve Board (FRB), "Federal Reserve Board announces it has formally joined the Network of Central Banks and Supervisors for Greening the Financial System, or NGFS, as a member,” accessed December 15, 2020.
20. Ibid.
27. Ibid.
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