FedFin Client Report

Thursday, March 18, 2021

Senate Battle Lines Drawn on Climate-Risk Financial Agenda

Client Report: GREEN7

Executive Summary

Today's Senate Banking Committee hearing on climate risk made it clear that the partisan divide evident earlier this week on housing (see Client Report **MORTGAGE119**) and much else extends to what financial regulators should do about climate risk. The SEC's new focus on investor disclosures (see FSM Report **GREEN6**) was perhaps the biggest target of Republicans strongly opposed to any mandatory climate-risk disclosures, stress testing, or similar interventions. Ranking Member Toomey (R-PA) led this charge, asserting that new standards are not only premature, but would also lead to credit allocation for political – not systemic-risk – reasons. Chairman Brown (D-OH) emphasized the importance of climate-risk controls, saving his most targeted comments for urging action to ensure that banks that make carbon-neutral policies are held accountable for achieving them. Democrats also asked for information on the extent to which climate modelling permits effective, standardized risk measurement without renewing specific demands for near-term FRB stress-testing. Interestingly, the ECB today signaled that EU banks could be forced to raise capital if stress testing shows them unduly exposed to climate risk.

Analysis

Opening Statements

Chairman Brown emphasized climate risks' systemic threat, noting however that it is not the role of the committee to vilify or support different energy sources. Citing a need to know where Wall Street is investing people's money, he also urged greater transparency.

Ranking Member Toomey sharply criticized the Fed and the SEC for straying beyond their mandates and into environmental policy, calling what he characterized as the SEC acting chair's proposal for "mandatory" climate disclosures "chilling and

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authoritarian." He also suggested that the real goal is to punish politically-unpopular industries.

Testimony

Gregory Gelzinis, Associate Director for Economic Policy at the Center for American Progress, urged regulators to mandate climate disclosures and integrate climate change into fiduciary obligations, stress testing, supervision, capital requirements, and systemic risk oversight.

Nathaniel Keohane, Senior Vice President at the Environmental Defense Fund, urged policymakers to implement a federal carbon price and the SEC to mandate climate disclosures.

Marilyn Waite, Climate and Clean Energy Finance Program Officer at The William and Flora Hewlett Foundation, similarly urged mandatory climate disclosures, climate-proofing the nation's balance sheet and strengthening the CRA to explicitly provide credit for clean energy loans.

John Cochrane, Senior Fellow at the Hoover Institution at Stanford University, argued that climate change poses no risk to the financial system, asserting an attempt to defund fossil fuels through "regulatory subterfuge."

Benjamin Zycher, Resident Scholar at the American Enterprise Institute, argued that is it not the place of financial institutions and regulators to look at climate change, positing that any climate disclosures would be speculative.

Q&A

- Systemic Risk: Sens. Tester (D-MT) and Ossoff (D-GA) worried about systemic risk; Mr. Gelzinis agreed, raising concerns about climate risk to large banks, the potential for a series of climate-associated shocks, and the pressure a simultaneous transition and large climate event would place on the financial system. Sen. Ossoff asked why markets are not currently pricing such risks; Mr. Gelzinis noted that investors do not have the necessary data.
- Stress Testing: Sen. Van Hollen (D-MD) asked if stress testing banks for climate risk could be beneficial, noting the need to create standard models; Mr. Gelzinis agreed.
- Climate Disclosures: Sens. Menendez (D-NJ), Tester, Warner (D-VA), Warren (D-MA), Van Hollen, Cortez Masto (D-NV) and Smith (D-MN) supported mandatory climate disclosures, which Sens. Toomey, Lummis (R-WY) and Daines (R-MT) opposed. Sen. Menendez asked how the SEC should approach

disclosures; Mr. Keohane suggested that the SEC focus on comparable, specific, decision-useful information. Sens. Warner and Cortez Masto noted significant investor interest in climate disclosures, and Sen. Warner asked about the competitive disadvantage of American companies without disclosure requirements. Mr. Gelzinis noted this undermines the health and attractiveness of the nation's capital markets. Sen. Smith asked how standardized climate disclosures would support more efficient deployment of capital; Ms. Waite believes disclosures would enable improved investor decision-making. Meanwhile, Sen. Lummis compared "Operation Choke Point" to current climate-related proposals; Mr. Zycher agreed that such disclosures would distort capital allocation away from certain industries due to politics. Sen. Daines asked if disclosures would decrease climate-related risks and why ESG funds have higher fees than index funds; Mr. Zycher believes they would not, noting that ESG funds have to be actively managed.

- Political Disclosures: Sen. Menendez supported political donation disclosures, saying that shareholders have a right to know if a company's political donations align with their publicly stated policy; Mr. Gelzinis agreed, noting investor interest.
- Role of Regulators: Sens. Toomey, Hagerty (R-TN), and Daines believe that climate change does not fall under the mandate of financial regulators, with Sen. Toomey arguing that climate change does not pose a threat to the financial system and thus regulators have no authority to deal with climate risk. Sens. Warren and Smith countered that climate change does fall under the mandate of financial regulators, particularly noting the risk to large banks and asset valuations. Sen. Toomey asked if the Fed is capable of navigating climate risks; Mr. Zycher does not believe financial regulators have the necessary expertise. Sen. Hagerty suggested that the private sector already has the necessary tools to make decisions based on climate risk; Mr. Zycher and Mr. Cochrane agreed.
- Climate Models: Sen. Toomey asked if climate models can provide meaningful information about near-term financial risk; Mr. Zycher believes they cannot. Sen. Tillis (R-NC) worried about the risk of moving too quickly with climate modeling; Mr. Zycher agreed, emphasizing increased energy costs and biased capital allocation, while Mr. Cochrane argued this would "pollute financial regulation." Sen. Cortez Masto asked if adequate climate modeling technology exists; Mr. Gelzinis and Ms. Waite noted improved technologies, but also that mandatory climate disclosures are needed to advance technologies.
- Carbon Goals: Chairman Brown asked what financial regulators should do to ensure banks reach their stated carbon goals; Mr. Gelzinis suggested stress testing, transition risk adjustments and risk management standards. Chairman Brown also asked what steps banks should take to show that they are making

progress towards their net-zero goals; Mr. Keohane emphasized greater transparency and engagement with oil and gas companies.

- Disparate Impact: Sen. Warnock (D-GA) noted racial disparities in climate housing impact, asking what Congress and regulators can do to help; both Mr. Gelzinis and Ms. Waite suggested a reformed CRA with integrated resilience and adaptation efforts. Mr. Gelzinis urged an increase in appropriations for Treasury's Community Development Financial Institution Fund, while Ms. Waite noted that FHFA can expand efforts to address climate change through programs such as Fannie Mae's multifamily green mortgage program.

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