Friday, October 22, 2021

# FSOC Treads Cautious Middle Path on Climate-Risk Action

**Client Report: GREEN11**

## Executive Summary

As we noted yesterday, the Financial Stability Oversight Council has now complied with President Biden's executive order (see FSM Report **GREEN8**), compiling an exhaustive assessment of the financial-stability implications of climate risk and what might best be done about it. Other than administrative action in areas such as procurement, the Biden order actually mandated little specific action, a stance dictated not only by the independent charters of key financial agencies, but also Treasury's hesitancy to press near-term stress tests, capital buffers, or other hard-wire interventions. As we expected when we assessed the executive order, FSOC's report includes an emphatic statement about what Secretary Yellen calls climate risk's "existential" threat, but its recommendations reflect and recognize significant data-analytic and even scientific-measurement challenges. Thus, as this client report makes clear, much now expressly recommended by FSOC is already under way at key U.S. financial regulators, with the most clear and immediate actions coming from the SEC on public-issuer and ESG disclosures and from the Fed on scenario analysis. While generally applauded by the industry, FSOC's report was criticized by climate activists. Congressional response will likely be along long-standing partisan lines (see Client Report **INVESTOR19**).

## Analysis

Much in the 129-page report analyzes climate financial risk and ongoing research on various ways to address it along with many new coordinating committees to enhance inter-agency communication and action. Substantive recommendations include:

- Agencies should, where possible, prioritize climate-risk technical capacity-building and risk analytics along with developing action plans, reporting to Congress and making data available to the public to the greatest extent possible. The Federal Insurance Office (FIO) – unusual among the agencies in that it reports to FSOC – is also given express instructions on how to accomplish these tasks for the insurance sector.

- A set of data-analytical tools should be developed and then deployed to identify gaps, coordinate inter-agency action, and improve both methodologies and the data on which they depend.
- Existing public disclosures should be updated where possible to enhance climate-risk understanding, basing work on emerging international principles and standardizing formats where appropriate. Specific greenhouse-gas (GHG) emission disclosures should also be given careful attention. "Scope 3" disclosures are not addressed directly. Although the need for disclosures by banks, insurers, and other sectors are noted, few specifics are provided.
- The SEC should also mandate public-issuer disclosures (as the Commission already plans to do following a recent RFI analyzed in FSM Report **GREEN6**). Ongoing SEC work on ESG funds to prevent greenwashing is also supported.
- Scenario analysis should be used where appropriate, with these analyses used for informational, as guides for supervisory intervention, or other purposes based on agency mandate and preference. Where possible, agencies should use common scenarios.
- Agencies should review existing rules and risk-management guidance to incorporate climate risk where appropriate.

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