



Federal Financial Analytics, Inc.

THE CLIMATE-RISK REGULATORY ROUND-UP

The political imperative of new climate-risk rules is so compelling that global and U.S. regulators are being forced to move faster than some think sensible. The near-term impact of this will be new disclosures and principles-based standards combined with high-profile scenario-analysis and penalty-charge regulatory build-out.

The analytics below are based on in-depth reports provided to FedFin clients.

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Although financial-industry CEOs dutifully trekked to Glasgow, they and the government officials gathered at the COP26 summit were far more certain of their concern than commitment. This may seem a cynical, not to mention commonplace, observation, but we don't mean it that way: the problem isn't the lack of real concern, but of clearly-effective solutions to the financial risk clearly posed by both physical and transition climate risk. As a result, regulators will work hard on the basic construct of climate-risk rules even as they issue near-term standards designed to ensure that banks – especially big ones – are insulated against near-term risk and well-prepared for those to come.

The conflict between the need for action and many analytical uncertainties is most clearly evident in new [standards proposed](#) by global bank regulators. As FedFin's [in-depth analysis](#) details, these principles-based standards are designed first and foremost to create a lowest common denominator ensuring that national authorities do something no matter what that something might be.

This is not to say that Basel's proposals are just rhetorical. Our careful read of the consultation details the step-by-step risk management and governance requirements we believe will be brought home to big U.S. banks in separate sets of standards from both the OCC and Federal Reserve. We also think the GSEs will soon be [forced to get greener](#) even though their regulator has so far prioritized an array of pressing, sometimes-political concerns.

Basel's proposal is also important to large U.S. banks and the GSEs on even consequential requirements: those for scenario analyses, stress testing, and – via these stress tests – new risk-based "brown-penalty" capital requirements. U.S. legislation intending to force the Fed's hand is pending on all of [these requirements](#). Later this week, we expect Chairman Powell to be closely quizzed on what the Fed plans to do about them.

Our analyses following these hearings and those to come will alert clients to the commitments Mr. Powell is forced to make to secure at least a bit more progressive support. We'll also be listening closely to what Lael Brainard promises the Fed will do about climate risk as she secures her vice-chair appointment. She'll need to temper her [views](#) in order to secure all the Democratic votes she'll need.

Given the high-level nature of global standards, triangulating between what Mr. Powell promises and Ms. Brainard signals defines the course of next year's climate-risk standards and the still more binding ones coming on their heels in 2023.

To learn more about Karen Petrou's book, *Engine of Inequality: The Fed and the Future of Wealth in America*, click [here](#)

Karen Petrou's latest column can be found [here](#)

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