# Global Climate-Risk Disclosures and Standards

**Cite**
Financial Stability Board, Consultative Report, Supervisory and Regulatory Approaches to Climate-Related Risk

**Recommended Distribution:**
Risk Management, Regulatory Reporting, Policy, Legal, Government relations

**Website:**
https://www.fsb.org/wp-content/uploads/P290422.pdf

## Impact Assessment

- The FSB is now developing micro- and macro-prudential climate considerations, creating a framework that could lead to systemic climate-risk standards governing only the largest institutions.
- "Green" capital benefits or "brown" penalty charges now are not considered appropriate near-term responses to climate-risk mitigation.
- The FSB supports only high-level disclosures at this time, noting challenges to determining the data that are best for comparability, especially on a cross-border and cross-sector basis.

## Overview

The FSB's report is aimed at establishing global standards that prevent fragmentation along national or regional lines as well as ensuring that regulatory and supervisory actions mitigate climate risk to the greatest extent possible in the face of an array of data and measurement challenges. Although the FSB proposes no specific requirements, its draft recommendations suggest that it will soon press global and national bank, securities, and insurance regulators to adopt macroprudential tools such as scenario analysis and stress testing to capture systemic interconnections primarily of concern at the largest financial institutions. The report also lays out issues for continued analysis to promote climate-risk policies going beyond credit and market risk to gain a better understanding of the interplay between physical, transition, and liability climate risk.

## Impact

The most immediate impact of FSB standards is likely to be on the climate risk-management principles recently proposed by the OCC and thereafter in slightly different form by the FDIC.[1] The FRB is also known to be working on similar standards, with all the agencies hoping to issue common risk-management principles this summer ahead of additional work on scenario analysis and, perhaps, the macroprudential tools assessed in the FSB report. U.S. standards will also draw directly on Basel's proposed risk-management principles,[2] but FSB's focus on systemic and cross-sectoral work advances bank-specific efforts and will be reflected as U.S. standards advance.

This consultative report follows FSB actions in 2020 to identify obstacles to stress testing and climate-risk capital rules[3] as well as possible systemic risks and related measurement challenges.[4] The BIS has focused intensively on climate risk, identifying the need for much of what the FSB now recommends but going beyond that to also propose climate-risk based capital charges.[5] These are also pending in proposed House legislation,[6] but the FSB barely mentions capital requirements and appears to have rejected them, other than with regard to supervisory add-ons.

Financial-sector climate-risk management would surely gain from reduced regulatory arbitrage across nations and between financial sectors as well as from greater transparency to the extent the FSB is able to first craft standards that are applicable across borders and climates and then gain their adoption. The global nature of climate risk makes the consistency sought here of particular importance, but it remains to be seen if national authorities are willing or able to concede on key points. Global standards would also provide data baselines from which nations could go beyond the risk-management and governance principles under U.S. development (see below) to more specific and even binding disclosures and risk-mitigation actions such as scenario analysis and stress testing.

The FSB in this report also clarifies possible boundaries between climate risk posing microprudential challenges warranting supervisory attention and those with systemic consequences that require macroprudential tools. The report is clearest with respect to how climate risk could turn systemic rather than on what these systemic risk-mitigation requirements should entail, perhaps planning to elaborate on them in a final report as well as in one planned for the future on cross-sector concerns. To the extent systemic standards are developed, regulatory burden would be alleviated for smaller companies, but the largest ones could be exposed to costly new requirements. The manner in which this occurs – e.g., by institutional designation or activity/practice standards – will determine the extent to which systemic risk is reduced and regulatory arbitrage is prevented within each financial sector and among them.

[1] See **GREEN12**, *Financial Services Management*, January 4, 2022.
[2] See **CLIMATE12**, *Financial Services Management*, November 22, 2021.
[3] See *Client Report* **GREEN3**, July 22, 2020.
[4] See *Client Report* **GREEN5**, November 23, 2020.
[5] See *Client Report* **GREEN**, January 22, 2020.
[6] See **GREEN10**, *Financial Services Management*, August 27, 2021.

## What's Next

The consultative report was released on April 29; comment is due by June 30. Although this document addresses cross-sectoral risks in numerous ways, the FSB also plans to focus only on it and perhaps develop additional standards in this arena.

## Analysis

### *A. FSB Conclusions*

This report includes case histories and a lengthy discussion of how climate-related risk presents itself and what supervisors, regulators, and financial institutions have under way to address it. Key conclusions are that:

- Climate-risk work to date generally fails to consider systemic and cross-sectoral effects. Systemic exposures are often poorly recognized, with a prime example cited as the interconnection between banks and insurers based on the importance of property insurance to mitigate credit risk. Feedback loops, non-linearity, and tipping points through sovereign debt and the real economy are also described.
- It is unclear if existing bank and insurance risk-management frameworks can handle climate risk or if stand-alone systems are required.
- It is also unclear if existing stress test methodologies are appropriate for climate related risk, but scenario analysis and stress testing are important aspects of risk mitigation to which jurisdictions should turn as data and methodology advances. Transition risk channels are particularly ill-understood.

### *B. Recommendations*

The FSB proposes that:

- Authorities should accelerate methodologies for identifying data needs, metrics, and other features key to effective risk management.
- Supervisory expectations should be set for data reporting and internal-audit review. Third-party verification should also be considered, especially with regard to preventing greenwashing.
- Authorities should consider using common definitions for physical, transition, and liability risk. Where supervisors need more data than available in public reports, authorities should initiate flexible reporting standards that, as improvements are observed, proceed to more specific and binding reporting.
- Systemic risk should be more fully considered, especially regarding cross-sector and -border risks. Work should quickly begin on credit and market risk and then proceed to other risk arenas (e.g., operational, liability, reputational, liquidity, and insurance underwriting).

- Jurisdictions should consider macroprudential tools to address systemic risk, focusing on scenario analysis and stress testing. All relevant financial sectors should be covered along with interdependencies between physical and transition risk and geographic and sector-specific hazards perhaps via hybrid models and the use of dynamic balance-sheet assumptions.

### *C. Request for Comment*

Questions are expressly posed on issues such as:

- the extent to which the report highlights the most important qualitative and quantitative data;
- if common high-level definitions are appropriate;
- whether recommendations achieve the FSB's goals;
- whether systemic issues are well identified, recommending scenario analyses and other remedies if appropriate. Comment is also sought on additional or alternative macroprudential tools;
- whether the description of current regulatory and supervisory actions is correct; and
- any other matters to be considered.