Mandatory Disclosure, Risk Integration + Supervisory Changes Fact Sheet

Problem

- Financial firms (including banks and investment advisers) require two levels of disclosures and analysis related to climate change: (1) their own risks, exposures and potential impacts and (2) the risks and impacts that they enable through financing others.
- While there is a lot of focus on direct climate-related risks and opportunities for non-financial companies, regulators, investors and the public need financial firms to have standardized, robust, and comparable methods to identify and assess the climate-related risks and impacts of the financing they provide.
- Prudential regulators must be cognizant of both the first and second-order risks to the financial firms themselves, as well as the long-term viability of the financial firms' behavior.
- However, under the Trump administration, banking regulators have generally not sought to identify, assess, or address these risks. To the contrary, the Office of the Comptroller of the Currency, for example, just proposed a rule to make it more difficult for banks to deny financing services to industries (such as arctic drillers) that may pose material ESG-related risks.

Solution

- The SEC and banking regulators should work together to develop detailed, bank-specific disclosures regarding the banks' climate-related risks, as well as similar types of disclosures for investment advisers regarding the climate-related risks to their funds.
    - Specifically for banks, the Securities and Exchange Commission (SEC) should revise its basic disclosure industry guide (Industry Guide 3) to enhance disclosure of climate-related risks that impact the banking industry:
        - Physical risks:
            - Build off of the September 2020 Task Force for Climate-Related Financial Disclosures (TCFD) Banking Pilot Project Phase II study for physical risk to banks, including assessments of risks to agricultural and real estate loan portfolios, including impact on borrowers of potential stranded assets;
            - Disclose operational risks to banks from having critical infrastructure in areas exposed to flooding, wildfires, and power outages;
        - Transition risks: disclose quantitative risks to bank portfolios (including to qualitative risks that must be disclosed according to Regulation S-K)

including in the form of credit risk, liquidity risk, and market risk. Existing Guide 3 Disclosures should be supplemented to include:

- Inclusion in the "Distribution of Assets" disclosure a new category of assets in sectors with more immediate and direct exposure to transition risks, such as those in fossil fuel and power industries ("high impact sectors");
- Bank investments in debt securities of issuers in high impact sectors, including weighted average yield of those investments;
- Bank loans to borrowers in high impact sectors, including
    - Maturity analysis (both expected maturity and legal final maturity, particularly for structured finance issuers);
    - Interest rate sensitivity;
    - Credit ratios and credit losses, including nonaccrual, past due, restructured, and "potential problem" loans;
    - "Foreign outstandings"; and
    - Loan loss experience in high impact sectors

- Propose and adopt rules (under (1) the Bank Holding Company Act for bank holding companies and (2) the Investment Advisers Act for investment advisers) that would provide enhanced disclosures regarding the climate risks and impacts, including:
    - Financed emissions, including implied negative emissions (deforestation) anywhere in the world, which should be expressed as a percent of total dollar value of combined portfolios invested in high-carbon emission sectors based on public data of the EPA's GHG Reporting Project;
    - The maturity of investments within and across all portfolios;
    - The value and number of investments in new projects within each sector; and
    - Scenario analyses for impacts of all portfolios from the 1.5 degrees C. above pre-industrial levels by 2050 (which reflects the implementation of the Paris Agreement).

- For these proposals related to financing impacts, the Partnership for Carbon Accounting Financials (PCAF) offers valuable methodologies and approaches to identifying and assessing "financed emissions."
- The PCAF effort, which was initially developed with the leadership of Amalgamated Bank, has recently had Morgan Stanley, Citi, and Bank of America all join and commit to it--bringing its total membership to more than 70 firms around the globe.

The US Springing Into the Lead on Climate Finance Accounting

- With the commitment to implement PCAF by Morgan Stanley, Citi, and Bank of America, two of the five largest banks in the US are now on-board. This could well lead to a "snowballing" effect with other banks.

Relevant Documents

- Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the US Commodities Futures Trading Commission Report "Managing Climate Risk in the US Financial System" September, 2020, *available at*: *https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf*
- Board of Governors of the Federal Reserve System, Financial Stability Report, Nov. 2020, *available at* https://www.federalreserve.gov/publications/2020-november-financial-stability-report-near-term-risks.htm.
- Document library at Duke University Climate Risk Disclosure Lab, *available at*: *https://climatedisclosurelab.duke.edu/voluntary-standards/*
- Reuters, Fed moves closer to joining global peers in climate-change fight, Nov. 13, 2020, *available at* https://www.reuters.com/article/climate-change-fed/fed-moves-closer-to-joining-global-peers-in-climate-change-fight-idUSL1N2HX25G (reflecting the Fed seeking membership in the Network of Central Banks and Supervisors for Greening the Financial System (NGFS).
- Morgan Stanley, Press Release: Morgan Stanley Joins Leadership of Global Carbon Accounting Partnership, July 2020, *available at* https://www.morganstanley.com/press-releases/morgan-stanley-joins-leadership-of-global-carbon-accounting-part.
- BankingDive, Citi, Bank of America join Morgan Stanley in carbon-disclosure group, July 2020, *available at* https://www.bankingdive.com/news/citi-bank-of-america-morgan-stanley-carbon-disclosure-group/582592/.
- Office of the Comptroller of the Currency, Proposed Rule: Fair Access to Financial Services, Nov. 2020, *available at* https://www.occ.gov/news-issuances/federal-register/2020/nr-occ-2020-156a.pdf.