



May 14, 2020

Mr. David M. Gillers
Alternate Designated Federal Officer
Climate-Related Market Risk Subcommittee
Commodity Futures Trading Commission
1155 21st St NW
Washington, D.C. 20581

Re: Policy recommendations for the Climate-Related Market Risk Subcommittee's report

Dear Mr. Gillers:

The Center for American Progress (“CAP”) is pleased to submit the following comment for the Climate-Related Market Risk Subcommittee’s (“Subcommittee”) consideration, as it drafts policy recommendations for financial regulators on the financial sector risks posed by climate change. CAP is an independent nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action.

Climate change poses clear risks to the stability of the financial system, as well as to retirement security, investor protection, and fair and efficient markets.¹ The increase in frequency and severity of catastrophic weather events and irreversible environmental changes (“physical risks”) could translate into heightened losses for financial intermediaries and investors exposed to an array of assets.² Financial institutions and investors that are imprudently financing assets that fuel climate change, or that are otherwise sensitive to the carbon price, could face sharp losses as the technological, market, and policy pressure to transition the economy away from fossil fuels becomes unavoidable (“transition risks”).³ It is important to underscore that financial markets are not only exposed to such risks, they are actively exacerbating them through the widespread continued financing of fossil fuel-intensive industries. The scope and scale of these risks, if unaddressed by financial regulators, could shock the financial system and lead to the myriad

¹ Gregg Gelzins and Graham Steele, “Climate Change Threatens the Stability of the Financial System,” Center for American Progress, November 21, 2019, available at <https://www.americanprogress.org/issues/economy/reports/2019/11/21/477190/climate-change-threatens-stability-financial-system/>.

Andy Green and Andrew Schwartz, “Corporate Long-Termism, Transparency, and the Public Interest,” Center for American Progress, October 21, 2018, available at <https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/>.

² Network for Greening the Financial System, “A call for action: Climate change as a source of financial risk” (Paris, FR: 2019), available at https://www.banque-france.fr/sites/default/files/media/2019/04/17/ngfs_first_comprehensive_report_-_17042019_0.pdf.

³ Ibid.

economic harms that come with a financial crisis.⁴ The current coronavirus-induced stress in the financial system provides a stark reminder that shocks, such as those associated with climate change, can come suddenly and from outside of the financial system itself.

Foreign central banks and financial regulators have begun to incorporate climate risk into their prudential regulatory, supervisory, and investor protection frameworks, but the U.S. is needlessly lagging behind.⁵ CFTC Commissioner Rostin Behnam should be commended for establishing the first official-sector subcommittee in the U.S. to consider the risks climate change poses to the financial system and the potential interventions policymakers could take to mitigate those risks.⁶ Given the grave threat that climate change poses to the U.S. financial system, we urge the Subcommittee to propose strong policy recommendations that will push regulators to act in a swift and aggressive manner to protect households, businesses, taxpayers, and the planet from the interlocking threats of climate change and financial sector risks.

Policy Recommendations

Regulators have powerful tools they can deploy to mitigate climate-related risks under existing statutory authority. The time for limiting action to public statements, reports, and ineffectual guidance is nearing an end. It is critical for financial regulators to begin implementing a robust climate-risk policy agenda immediately, given the magnitude and intensifying nature of these risks. The following five recommendations do not constitute an exhaustive list of appropriate policy actions, but they should serve as fundamental pillars of any climate-risk policy agenda.

1. The Securities and Exchange Commission (“SEC”) should mandate the maximum level of public disclosure from companies, funds, and other market participants under its jurisdiction regarding their exposure and contribution to climate-related risks and, specifically, their level of greenhouse gas emissions, including the emissions of the assets they finance, consistent with the Greenhouse Gas Protocol.⁷ Regulators, investors—in particular, so-called universal owners who cannot diversify away from climate risk—and indeed other market participants and the taxpaying public need clear, comparable, and reliable data to better understand companies’ climate risk exposure and their direct and indirect contributions to climate change, including the level of Scope 1, 2 and 3 emissions associated with each firm. Such information, especially regarding financed-emissions from financial institutions and capital markets participants, is critical to effective business, financial and regulatory decisions. In addition, the Federal Reserve Board should also deploy its public disclosure authorities to secure market discipline around financial institution-financed greenhouse gas emissions.

⁴ Gregg Gelzinis and Graham Steele, “Climate Change Is a Financial Crisis, Too,” Bloomberg Opinion, November 19, 2019, available at <https://www.bloomberg.com/opinion/articles/2019-11-19/climate-change-is-a-financial-crisis-too>.

⁵ Network for Greening the Financial System, “International role,” available at <https://www.banque-france.fr/en/financial-stability/international-role/network-greening-financial-system> (last accessed May 2020).

⁶ <https://www.cftc.gov/PressRoom/PressReleases/7963-19>

⁷ Partnership for Carbon Accounting Financials, “Carbon accounting standard and data,” available at <https://carbonaccountingfinancials.com/global-carbon-accounting-standard> (last accessed May 2020).

2. The Federal Reserve Board should establish climate risk stress tests for our nation’s largest financial institutions. These tests would help demonstrate the aggregate and individual climate risk exposure and contributions of major financial institutions. But climate risk stress tests must not merely serve as fact-finding exercises. It is critical for stress testing to play a core role in climate risk supervision. They should be used to embed climate risk as a key consideration in firms’ governance, risk management, internal controls, and capital planning processes. It is therefore important for these stress tests to have teeth—mechanisms for penalizing institutions that are not meeting supervisory expectations. For example, institutions that fall short of supervisory expectations in the stress tests should see their capital distributions restricted until the failures are remedied, akin to the “qualitative objection” that was formerly part of the annual macroeconomic stress tests. Senator Schatz’s and Representative Casten’s Climate Change Financial Risk Act of 2019 provides a roadmap for a robust stress testing regime.⁸

3. Financial institutions regulators, including insurance regulators, should broadly incorporate climate risk, including at the individual firm and systemic risk level, into their prudential regulatory and supervisory frameworks for all financial institutions, and in particular systemically important financial institutions. These rules should include higher capital and margin requirements, supervisory guidance, and risk management standards.⁹ Information and data collected from the disclosure and stress testing programs would necessarily inform the precise design of such policies. Importantly, an appropriate macroprudential approach to climate must include expanding the Federal Reserve’s regulatory perimeter for nonbank financial companies, such as asset management firms, insurance companies, and other shadow banks that do not presently face regulation and supervision commensurate with the risks they pose to the financial system, including related to climate risk. The Financial Stability Oversight Council (“FSOC”) should use its authority to designate such firms as systemically important, which would place them under the Fed’s jurisdiction. Even more aggressive interventions should also be considered for banks and systemically important shadow banks, including portfolio limits for certain assets particularly exposed to climate-related risks, such as fossil-fuel related assets.

4. Investors and consumers should be protected from climate-related financial risks. Specifically, the SEC and the Department of Labor, respectively, should overhaul and fully integrate climate risks and impacts into their frameworks for how market participants are to operate in the best interests of clients. Climate change poses serious risks to investors and retirement security, and all financial intermediaries must have stringent obligations to limit those risks for their clients and fully incorporate the mitigation of risks into the services they provide for clients. For example, low-carbon funds should be the industry standard as the default investment for all parties, while credit rating agencies should fully incorporate climate risks into their analyses. The SEC should also fully secure all investors’ rights to take action on climate through effective corporate governance tools such as shareholder proposals and proxy access.

⁸ U.S. Senator Brian Schatz, “Schatz Introduces New Legislation To Ensure U.S. Financial System Is Prepared For Climate Change,” Press Release, November 20, 2019, available at <https://www.schatz.senate.gov/press-releases/schatz-introduces-new-legislation-to-ensure-us-financial-system-is-prepared-for-climate-change>.

⁹ Graham Steele, “A Regulatory Green Light: How Dodd-Frank Can Address Wall Street’s Role In The Climate Crisis” (Washington, D.C.: Great Democracy Initiative, 2020), available at https://greatdemocracyinitiative.org/wp-content/uploads/2020/01/Final_Greenlight_Steele.pdf.³

5. The Fed should evaluate and publicly disclose the risks that climate change poses to its emergency lending portfolio. In particular, it should account for and publicly disclose the greenhouse gas emissions it is financing through its emergency lending facilities. Financing the industries that are intensifying climate change and fueling physical risks to the financial system would run counter to its financial stability mandate. As such, the Fed should seek to limit the financed emissions of its portfolio. The NGFS has called on central banks to incorporate a climate risk perspective into their own balance sheet decision-making so as to not to contribute to problems they have a responsibility to solve.¹⁰

Conclusion

These policies, if implemented aggressively, would substantially limit the chances of a climate-driven financial crisis. Now is the time to act. The longer regulators wait, the greater the likelihood that households, businesses, taxpayers, and the planet suffer the grave consequences of inaction.

Thank you for considering these comments and CAP looks forward to carefully analyzing the Subcommittee's forthcoming report.

Sincerely,

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¹⁰ Network for Greening the Financial System, "A sustainable and responsible investment guide for central banks' portfolio management" (Paris, FR: 2019), available at <https://www.ngfs.net/sites/default/files/medias/documents/ngfs-a-sustainable-and-responsible-investment-guide.pdf>.