Financial Stability Oversight Council Report on Climate-Related Financial Risk: **Seven Things To Know**

On Thursday, October 21, 2021, the Financial Stability Oversight Council ("FSOC" or "Council") released a Report on Climate-Related Financial Risk (the "Report"). The Report represents the culmination of a deliberative process that began on May 20, 2021, when President Biden signed an Executive Order on Climate-Related Financial Risk. That order required FSOC to issue a report on efforts by its member agencies to integrate climate-related financial risk into their policies and specifically mandated discussions of (i) climate-related disclosure; (ii) climate-related regulation and supervision; (iii) the identification and measurement of climate-related financial stability risk; and (iv) other recommendations for climate risk mitigation, including new or revised regulations.

1 The Report marks an important moment in the Biden Administration's "whole-of-government" approach to climate change and devotes considerable attention to building the case for climate change as a proper object of concern for financial regulation.

Throughout the Report's 133 pages — a length that substantially exceeds that of prior FSOC reports and demonstrates financial regulators' commitment to addressing climate issues — the Council examines and describes in detail how climate change threatens financial stability. The Report is a milestone for the Biden Administration, and it confirms a clear new consensus among regulatory leadership that climate risk mitigation is a core priority for federal financial agencies.

2 Notwithstanding its forty recommendations, the Report largely reiterates and reinforces existing agency views and initiatives, rather than announce new or different regulatory priorities.

Despite the Report's frequent calls for future action, the Report's focus remains somewhat retrospective, detailing descriptions of prior climate-related financial policies, and its forward-looking recommendations closely adhere to its member agencies' previously announced frameworks. Accordingly, the Report does not mark a major shift in policy or new set of priorities in this area. As Treasury Secretary Yellen noted during her remarks at the FSOC meeting, this Report represents merely a "first step" in the development of policies to address climate-related financial risk.

3 On climate-related disclosures, the Report largely defers to ongoing SEC initiatives but emphasizes how bank regulators can use their reporting and data collection powers to assess bank risk management capabilities, build system-wide views of risk, and provide useful information to investors and other market participants.

The Report describes and effectively endorses the SEC's ongoing work to develop climate disclosure requirements for public issuers that would promote consistent, comparable, and decision-useful disclosures for investors regarding climate-related risks and opportunities. The Report also focuses on the SEC's evaluation of the requirements for registered funds' and investment advisers' climate-related disclosures and claims.

In addition, the Report places significant emphasis on the role of the federal banking agencies in enhancing disclosure of climate risks. The Report explores the possibility of incorporating a number of climate-related elements into bank regulatory reports, including climate risk assessments, scenario analyses, and Scope 1, 2, and 3 emissions data under the Greenhouse Gas Protocol. In particular, the Report describes financed emissions data as an "area of promise" and suggests that regulators may seek to understand how supervised banking organizations are developing their respective financed emissions data methodologies. According to the Report, climate-related bank regulatory reporting is a supervisory mechanism that would inform regulators of individual bank and system-wide risks and investors of material climate exposures.

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4 The Report emphasizes scenario analysis as a tool for assessing climate risk and, notwithstanding existing data gaps and challenges, advocates the adoption of scenario analysis as a critical source of bank supervisory and systemic risk information.

Although the Report highlights increasingly sophisticated scenario analysis methods, the Report does not envision FSOC's member agencies utilizing these economic frameworks to conduct independent scenario analyses for regulated institutions; instead, the Report focuses on how banks and other regulated entities can conduct their own scenario analyses, and how regulators would use the result of those analyses. Taken together, the Report's discussion of scenario analysis strongly suggests that regulatory and supervisory oversight of banks' own scenario analysis capabilities, and the results of such exercises, will serve as a foundational element of the FSOC member agencies' approach to climate risk.

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5 The Report distinguishes scenario analysis from stress testing, and does not recommend incorporating scenario analysis into bank capital requirements or otherwise altering the capital framework to address climate-related risk.

The Report offers a clear and definitive statement on the relationship between scenario analysis and stress testing: for the FSOC, scenario analysis and stress testing are separate tools. Thus, the Report does not propose incorporating scenario analysis into Comprehensive Capital Analysis and Review for purposes of capital requirements, nor does it discuss amending capital requirements to specifically reflect climate-related risk.

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6 Consistent with the Council's previous reports and statutory mandate, the Report issues recommendations rather than direct orders to FSOC's member agencies.

The Report couches its recommendations in precatory terms, generally asking member agencies to "consider" particular courses of action. This advisory stance reflects FSOC's longstanding approach to inter-agency coordination and statutory power to recommend agency actions, rather than compel them.

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7 The Report represents a shift to a more engaged and proactive FSOC.

Both the length and breadth of the Report suggest that the anticipated shift under the Biden Administration to greater and more active engagement by FSOC on financial stability issues is well underway.

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