



## Financial Services & Products / Securities Law ADVISORY ■

**DECEMBER 1, 2020**

### The Longer Term Does Arrive over Time—Financial Services Regulators and Investors Gearing Up for Climate Change Reforms

by [\*Cliff Stanford\*](#), [\*Dave Brown\*](#), [\*Julie Mediamolle\*](#), [\*Nathan Tyre\*](#), and [\*Luke Trompeter\*](#)

Since the 1990s, financial regulators have been busy dealing with the dot-com bubble, the global financial crisis, the implementation of the Dodd–Frank Act, cybersecurity, and the digitization of financial markets, among other examples. Now they are poised to add climate change to the mix. President-elect Biden has declared climate change to be one of his four top [priorities](#) and named John Kerry as special presidential envoy for climate to the National Security Council – a move that further signals the importance of climate change to the incoming Administration. Additionally, a growing list of regulators are speaking out about the imminence of climate change reforms. Commenting on shifting climate change perspectives, Federal Reserve Chair Jerome Powell recently [noted](#), “the longer term does arrive over time.”

#### **Expected Reforms**

Recent statements signal that regulators are most concerned about impacts of climate change on financial stability and systemic risk, such as the potential for “abrupt repricing events” or even an extremely complex and unpredictable “green swan” event where climate change shocks expose market fragility. Policy circles now talk of “transition risks” as the economy adapts to climate change.

However, regulators and others are homing in on actionable steps to enable individual firms to avert or absorb such shocks over time and gradually move toward transparency and accurate pricing of potential climate change risks.

Regulators are likely to emphasize:

- Enhancing public company disclosures.
- Embedding climate-related risks as a key consideration of governance and risk management.
- Incorporating climate-related risks into stress testing and scenario analysis.
- Risk-pricing reviews.

This alert is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

With the Biden Administration expected to rejoin the Paris Climate Accord and the Federal Reserve expected to join the [Network for Greening the Financial System](#) (NGFS), industry participants should expect international best practices to be a key source for any potential domestic reforms. Notably, the Basel Committee's Task Force on Climate-related Financial Risks (TCFR) is expected to complete its fundamental [research](#) on climate risk transmission channels as well as methodologies for measuring and assessing such risks by mid-2021. In the United Kingdom, regulators have adopted a guide to climate-related financial risk management through the [Climate Financial Risk Forum](#) (CFRF). Further, emphasis on climate-related risks is not just emerging at the federal and international levels. For example, the New York State Department of Financial Services has been notably [active](#), and other states are expected to follow.

It is likely that environmental, social, and governance (ESG) advocates will seek to capitalize on the present political relevance of climate change in the coming months, and industry participants will step up self-policing measures in an effort to stay potentially burdensome regulations. While enhanced disclosures have been expected and championed by proxy advisors, institutional investors, and others, the anticipated inclusion of stress testing, pricing, and risk management reviews represent a near-termining of risks that were once considerations only for long-term strategic planning.

New public company disclosure and financial firm reporting requirements about climate change are likely to derive from two sources with two distinct, though not necessarily incompatible, agendas:

- On the one hand, ESG advocates favor enhanced disclosures to enable investors to make informed decisions about whether to invest in a company based on their own values and convictions and an assessment of the risks to the company associated with climate change.
- On the other hand, financial services regulators are concerned that a lack of climate change risk exposure data may be causing market pricing errors that may lead to staggered, and painful, pricing corrections.

### ***Investor pressures on climate change disclosures***

Although the SEC has thus far declined to further mandate or standardize climate change disclosure, investors have continued to publicly push companies to be proactive on the subject. In a January 2020 [letter](#), BlackRock CEO Larry Fink stated that the firm would avoid investing in companies that "present a high sustainability-related risk." Fink openly supports the UK's current approach to a climate change disclosures regime, which will impose the recommendations of the [TCFR Financial Disclosures](#) wholesale in 2021 on companies listed on the LSE. Such required disclosures include:

- Management's assessment of and actions on climate-related risks and opportunities.
- Identified climate-related risks and opportunities, their impact on the business, and the company's strategic planning resilience to climate-related scenarios.
- Processes for identifying, assessing, and managing climate-related risks.
- Metrics used to assess climate-related risks and opportunities.
- Reports of any climate change scenario analysis.

Further, the Partnership for Carbon Accounting Financials (PCAF) recently introduced global accounting [standards](#) to allow organizations to comparatively gauge the impact of financial transactions. Additionally, ISS's 2021 voting [guidelines](#) will generally recommend votes against boards or individual directors if there are material failures of governance, stewardship, or risk oversight of *environmental and social issues, including climate change*. ISS is particularly focused on companies and directors in high-impact industries and expects directors to increase their oversight of their organization's climate change risk profile.

### ***Federal regulatory developments***

**SEC:** Twice in the past six months ([August](#) and [November](#)), the SEC has adopted amendments aimed at modernizing MD&A disclosure requirements, and both times they declined to directly address climate change issues. Additionally, the SEC separately rejected a May 2020 [recommendation](#) from the Investor Advisory Committee calling for the implementation of new ESG disclosure requirements. Commissioners Allison Herren Lee and Caroline Crenshaw have voiced strong [objections](#) to the SEC's failure to act on ESG and climate change disclosures. The closest currently required climate-related disclosure is in Item 101 of Regulation S-K, which requires issuers to disclose the material effects that compliance with environmental regulations may have on an issuer's "capital expenditures, earnings and competitive position" and Item 103 of Regulation S-K, which requires a description of the material risks of investing in the issuer. The amendments adopted in August require issuers to disclose more information on their human capital management but do not provide much guidance on what an issuer needs to include, which will lead to varying levels and types of disclosure by issuers.

The expected [departure](#) of SEC Chairman Jay Clayton will allow the incoming Biden Administration to name a new SEC commissioner and to nominate a new chairman, moves that could pave the way for previously roadblocked reforms to both ESG and climate-related disclosures. In a November 2020 [speech](#), Lee described a potential course of action for the SEC in 2021, stating that "the SEC should work with market participants toward a disclosure regime specifically tailored to ensure that financial institutions produce standardized, comparable, and reliable disclosure of their exposure to climate risks."

**Prudential Banking Agencies:** The Federal Reserve's November 2020 [Financial Stability Report](#) warns that the current imperfect understanding of climate change risks exposes markets to sudden and extreme repricing events. Repricing events are no longer restricted to the information gleaned from isolated climate change events but also from shifting market participants and consumer expectations. As markets become more attuned to climate change risks, at-risk market participants and assets (e.g., coastal real estate) could experience sudden downward price shocks. To curb such shocks, new disclosure requirements are likely to target mispricing risks with increased disclosure requirements around climate-related exposures.

Financial industry participants should expect supervisory themes to begin to dovetail with climate change disclosure requirements. As new standards are established for assessing and benchmarking climate-related risks, supervisors may interject those standards into firm-specific supervision. This could include (1) pricing and risk management policy and procedure reviews; (2) asset pricing model reviews; (3) asset allocation and portfolio concentration reviews; and (4) stress testing. These processes are likely to consider specific climate change events, general climate risk trends and related systemic risks, carbon emissions, and independent regulatory requirements (e.g., federal loan and disaster recovery requirements).

Taken too far, these expected efforts are not without controversy. For example, if regulators take steps to impose asset risk weighting or stress testing standards that "pick winners" by emphasizing favored industries or shunning disfavored industries, this could have consequences beyond ensuring the safety and soundness of institutions or mitigation of systemic risk.

**CFTC:** The CFTC's Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee recently published a [report](#) finding that climate change "poses a major risk to the stability of the U.S. financial system," and central to that risk is a lack of understanding about how "different types of climate risk could interact" with each other and with seemingly unrelated risks such as "historically high levels of corporate leverage" and the COVID-19 pandemic.

The report calls for, among other things, (1) a recognition that climate change poses systemic and sub-systemic risks to the U.S. economy; (2) an economy-wide carbon pricing structure; (3) increased data and disclosures material to climate-related financial risk; and (4) standardized definitions and accounting regimes. Finally, the report notes that international engagement by the U.S. on climate change “could be significantly more robust” – a wish the Biden Administration is likely to grant.

## **What Should Your Institution Be Doing Now?**

### ***Prepare board and management oversight structures***

- Establish which board committee will be responsible for oversight of climate-related matters. It could be risk focused and fall under the audit committee or fall with the nominating and governance committee’s oversight of ESG issues.
- Evaluate the various management functions/departments that will need to consider these issues and create a structure for gathering and reporting information and evaluating the effectiveness of initiatives.

### ***Interject climate change considerations into enterprise risk management disciplines***

- Early and iterative critical self-analysis is important to the identification of often subtle climate-related risks and will prepare you for any future regulatory action.

### ***Conduct industry analysis/benchmarking***

- Review and assess the current voluntary disclosure regimes on ESG information and decide the ESG disclosure priorities, if any.
- Begin benchmarking disclosures on climate-related risks, governance and risk management practices, and other ESG-related information against peers.
- Consider engaging with investors to understand their expectations for any ESG-related disclosures.

### ***Begin quantifying and qualifying climate change risk exposure***

- Develop reports and other mechanisms to allow your board and management team to begin analyzing exposure to climate change risks.

### ***Consider early adoption of climate change accounting and reporting standards***

- Consider whether early adoption of the PCAF accounting [standards](#) and/or TCFD’s disclosure [standards](#) is right for your organization.
- Consider what structural changes your organization would need to accomplish to comply with such standards if they are adopted by U.S. regulators.

You can subscribe to future *Financial Services & Products* and *Securities* advisories and other Alston & Bird publications by completing our [publications subscription form](#).

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any member of our [Financial Services & Products](#) or [Securities](#) Groups.

---

[Clifford S. Stanford](#)

404.881.7833

[cliff.stanford@alston.com](mailto:cliff.stanford@alston.com)

[David A. Brown](#)

202.239.3463

[dave.brown@alston.com](mailto:dave.brown@alston.com)

[Julie Mediamolle](#)

202.239.3702

[julie.mediamolle@alston.com](mailto:julie.mediamolle@alston.com)

[Nathan D. Tyre](#)

404.881.7170

[nathan.tyre@alston.com](mailto:nathan.tyre@alston.com)

[Luke H. Trompeter](#)

202.239.3226

[luke.trompeter@alston.com](mailto:luke.trompeter@alston.com)

# ALSTON & BIRD

---

[WWW.ALSTON.COM](http://WWW.ALSTON.COM)

© ALSTON & BIRD LLP 2020

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777

BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86.10.85927500

BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719

CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111

DALLAS: Chase Tower ■ 2200 Ross Avenue ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899

FORT WORTH: 3700 Hulen Street ■ Building 3 ■ Suite 150 ■ Fort Worth, Texas, USA, 76107 ■ 214.922.3400 ■ Fax: 214.922.3899

LONDON: 5th Floor ■ Octagon Point, St. Paul's ■ 5 Cheapside ■ London, EC2V 6AA, UK ■ +44.0.20.3823.2225

LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100

NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444

RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260

SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001

SILICON VALLEY: 1950 University Avenue ■ Suite 430 ■ East Palo Alto, California, USA 94303 ■ 650.838.2000 ■ Fax: 650.838.2001

WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333