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Creating a climate of change digest

Climate risk regulatory developments in the financial services industry

Leading off

On October 24, 2023, the federal bank regulatory agencies—Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC)—jointly finalized principles for climate-related financial risk management for large financial institutions.[1]

In December 2021,[2] March 2022,[3] and December 2022,[4] the OCC, FDIC, and FRB, respectively, had proposed substantively similar guidance on risk management principles to support the effective management of climate-related financial risks for the financial institutions they supervise.

Feedback received on these proposed principles urged the agencies to coordinate among each other and work with other US and international regulators and federal agencies to harmonize approaches and to share knowledge with respect to climate-related financial risks. The agencies agree and address this feedback with the joint issuance of a high-level framework for the safe and sound management of exposures to climate-related financial risks for large financial institutions.[5]

The final set of principles do not differ from the draft principles to a great extent. The takeaways from the final set of principles in comparison to the draft principles, are tabulated below.[6]

Topic	Takeaways
Supervisory authority of the agencies	• The principles assert that the agencies are responsible for ensuring the safety and soundness of supervised financial institutions and that climate-related financial risks can affect financial institutions' safety and soundness. • The principles neither prohibit nor discourage financial institutions from providing banking services to customers of any specific class or type, as permitted by law or regulation. • The decision regarding whether to make a loan or to open, close, or maintain an account rests with the financial institution, so long as the financial institution complies with applicable laws and regulations.
Scope	The principles are applicable for financial institutions with more than $100 billion in total consolidated assets. This includes foreign banking organizations with combined US operations of greater than $100 billion, and any branch or agency of a foreign banking organization that individually has total assets of greater than $100 billion.
Financial institutions' public climate commitments	There are no new requirements in the context of financial institutions' public commitments. Like the draft principles, the final principles state that any financial institution's climate-related strategies should align with and support the institution's broader strategy, risk appetite, and risk management framework.
Risk materiality	The final principles clarify that management is required to incorporate climate-related financial risks into their risk management frameworks where those risks are material.
Low-and-moderate-income (LMI) and other underserved consumers and communities	The final principles clarify that financial institutions should ensure that fair lending monitoring programs review whether and how the financial institution's risk mitigation measures potentially discriminate against consumers on a prohibited basis, such as race, color, or national origin. For example, as part of strategic planning, the board is required to encourage management to consider the impact that the financial institution's strategies to mitigate climate-related financial risks could have on LMI and other underserved communities and their access to financial products and services, consistent with the financial institution's obligations under applicable consumer protection laws.
Governance	The final principles clarify the role of the board of directors in overseeing the financial institution's risk-taking activities and the role of management in executing the strategic plan and risk management framework.

On October 12, 2023, the Task Force on Climate-related Financial Disclosures (TCFD) completed its work with the publication of the 2023 status report on companies' climate-related disclosures.[7]

The TCFD was asked by the Financial Stability Board (FSB) to maintain momentum by monitoring and reporting on progress in companies' disclosures of climate-related financial information, until the release of the global sustainability disclosure standards by the International Sustainability Standards Board (ISSB).[8] The TCFD therefore continued its work to promote and monitor progress in companies' implementation of the 2017 TCFD Recommendations and published the status report in October.[9]

This report describes companies' progress in making climate-related financial disclosures and the challenges faced in making such disclosures. The report also provides an update on significant actions by governments, regulators, and standard-setters to use the TCFD recommendations in developing climate-related disclosure requirements.[10]

The findings from the report are summarized below:[11]

1. The percentage of public companies disclosing TCFD-aligned information continues to grow, but more progress is needed. For fiscal year 2022 reporting, 58% of companies disclosed in line with at least five of the 11 recommended disclosures—up from 18% in 2020; however, only 4% disclosed in line with all 11.
2. The percentage of companies reporting on climate-related risks or opportunities, board oversight, and climate-related targets increased significantly—by 26, 25, and 24 percentage points, respectively—between fiscal years 2020 and 2022.
3. Disclosure of climate-related financial information in financial filings is limited. On average, for fiscal year 2022, information aligned with the 11 recommended disclosures was four times more likely to be disclosed in sustainability and annual reports than in financial filings.
4. The majority of jurisdictions with final or proposed climate-related disclosure requirements specify that such disclosures be reported in financial filings or annual reports.
5. More than 80% of the largest asset managers and 50% of the largest asset owners reported in line with at least one of the 11 recommended disclosures.
6. Based on a 2022 TCFD survey, asset managers and asset owners indicated the top challenge to climate-related reporting is insufficient information from investee companies.

The publication of the status report in October 2023 marks the TCFD's final task and brings an end to TCFD's eight years of work. With the publication of ISSB Standards in June 2023, the Task Force will be disbanded and ISSB will assume the responsibility for monitoring companies' progress on climate-related disclosure as of next year.[12]

On October 12, 2023, FSB published its annual progress report on climate-related disclosures.[13] The report elaborates FSB's progress on the comprehensive Roadmap[14] to address climate-related financial risk, which was adopted in July 2021.

FSB notes that noteworthy progress has been made this year toward setting a global framework of climate reporting standards. The report highlights the publication of climate-related disclosure standards by the ISSB in June 2023[15] and calls on jurisdictions to take timely action and consider ways in which they might adopt, apply, or otherwise be informed by the ISSB Standards. The report emphasized the importance of interoperability of the ISSB Standards with jurisdictional disclosure frameworks for achieving global comparability of climate-related disclosures.

The report also outlined progress toward the development of assurance and ethics standards for sustainability-related corporate reporting and covered the advances made by the International Auditing and Assurance Standards Board (IAASB), the International Ethics Standards Board for Accountants (IESBA), and the progress made by the International Organization of Securities Commissions (IOSCO).

FSB reports the results of the survey it conducted for its member jurisdictions in July 2023, to track their progress on climate-related disclosure practices. According to the survey, three-quarters of jurisdictions already have requirements, guidance, or expectations in place for climate-related disclosures.[16]

The report also mentioned that the work of TCFD has ended as of October 2023 with the publication of the *2023 TCFD Status Report*.[17]

On October 11, 2023, FSB published its latest annual report on its work to promote global financial stability.[18] The report includes climate change as an elevated vulnerability in the global financial system and outlines the work FSB is doing to address the financial risks from climate change.

Key takeaways:[19]

1. The report recognizes the publication of global sustainability disclosure standards by the ISSB as a milestone development in addressing the financial risks from climate change.
2. FSB also lists the progress made on other areas of the comprehensive Roadmap[20] to address climate-related financial risk. FSB has continued its work in improving the availability, quality, and cross-border comparability of climate data and in the assessment of climate-related vulnerabilities. The report notes that there are ongoing initiatives on embedding climate-related risks into risk management and prudential frameworks. FSB also informs of its effort to examine the climate financial risk factors in compensation frameworks.

On September 28, 2023, the Biden-Harris administration released the National Climate Resilience Framework, which is designed to guide and align climate resilience investments and activities by the federal government and its partners.

The Framework was released in the very first White House Climate Resilience Summit, which was attended by representatives from more than 25 states, territories, and Tribal Nations. The Summit aimed to discuss locally tailored, community-driven strategies for climate resilience and to discuss opportunities for maximizing the impact of the funds provided for climate resilience in President Biden's Investing in America agenda[22] and in the President's Emergency Plan for Adaptation and Resilience (PREPARE).[23]

The National Climate Resilience Framework, introduced in conjunction with the Summit, outlines principles and actions to achieve the following six objectives.[24]

1. Embed climate resilience into planning and management.
2. Increase resilience of the built environment to both acute climate shocks and chronic stressors.
3. Mobilize capital, investment, and innovation to advance climate resilience at scale.
4. Equip communities with information and resources needed to assess their climate risks and develop the climate resilience solutions most appropriate for them.
5. Protect and sustainably manage lands and waters to enhance resilience, while providing numerous other benefits.
6. Help communities become not only more resilient, but also more safe, healthy, equitable, and economically strong.

The Framework articulates a common definition of resilience and fundamental principles that will guide the federal government's approach to achieving resilience. The Framework then expands on the six core objectives by providing a high-level description of what each objective would entail, an overview of notable federal investments and initiatives that have supported the objective to date, and an illustrative list of specific opportunities for cross-sectoral action.[25]

The Framework is expected to be a baseline for near-term and longer-term climate resilience efforts across the federal government. The release of the Framework and the Summit together sends a signal that environmental and economic justice has been placed at the center of the government's climate resilience agenda.

The Network for Greening the Financial System (NGFS) has introduced short-term climate scenarios to enhance financial resilience. These scenarios, covering a three-to-five-year horizon, address immediate impacts and transition risks.[26]

NGFS has taken a significant step by releasing a "Conceptual Note on Short-term Climate Scenarios." These scenarios are designed to address the immediate macro-financial impacts of transitioning to a net-zero economy and the consequences of severe natural disasters. The short-term scenarios encompass a three-to-five-year horizon, bridging a gap in the analysis of climate-related risks that tend to focus on the medium to long term. This initiative is a response to public feedback received in February 2023, highlighting the need for short-term scenario integration within the NGFS framework.

The Conceptual Note outlines five distinct climate scenario narratives that form the foundation of the short-term dynamics associated with transition and physical impacts. These narratives are shaped by geopolitical, economic, and technological factors, resulting in a range of possible future outcomes. Three scenarios emphasize mitigation through stringent climate policies, each featuring different timings and combinations of macro-financial and technology-related shocks. These scenarios highlight transition risks and align with long-term goals for mitigating global warming. Another scenario underscores high near-term physical risks, while the final narrative considers both significant transition and physical risks due to international policy divergence. To implement these scenarios, an experienced modeling team will be selected through a Call for Expression of Interest, initiated by NGFS in May 2023.

These narratives not only differ in the sources of shocks but also provide insights into various transmission channels, key model parameters, and choices related to fiscal and monetary policy. Developed by the NGFS Workstream on Scenario Design and Analysis, these narratives serve as the basis for climate stress testing relevant to central banks' prudential and supervisory responsibilities. They can also offer valuable insights into macroeconomic impact assessments that are pertinent to monetary policy decisions, aligning with the NGFS Workstream on Monetary Policy's objectives.

The release of short-term climate scenarios by NGFS equips central banks and supervisors with the necessary tools to understand the near-term macro-financial implications of climate risks, providing a means to enhance financial stability while navigating the challenges presented by climate change and the transition to a sustainable economy.

The Basel Committee on Banking Supervision (BCBS) met October 4–5, 2023, in Basel to discuss the outlook for the global banking system, in light of recent economic and financial market developments, and to discuss a range of policy and supervisory initiatives.[27]

In its meeting, the Committee recognized the March 2023 banking turmoil as the most significant systemwide banking stress since the global financial crisis, in terms of its scale and scope, and published a report to provide an assessment of the causes of the banking turmoil, the regulatory and supervisory responses, and the initial lessons learned from the turmoil.[28] The Committee asked banks and supervisors to take caution of the vulnerabilities that may arise as they move away from the low-interest-rate era.

Among other topics, the Committee agreed to consult on a Pillar Three disclosure framework for bank exposures to climate-related financial risks. The Committee is expected to publish a consultation paper on this proposed framework by November.[29]

California enacts SB-253, the Climate Corporate Data Accountability Act, and SB0261, the Climate-Related Financial Risk Act, into law: Groundbreaking climate disclosure laws for businesses mandate GHG emissions and financial climate risk reporting, enhancing transparency and climate action.[30]

California Governor Gavin Newsom signed two groundbreaking climate bills on October 7, 2023, which mandate companies with substantial revenue to make climate-related disclosures, commencing in 2026. These bills, the Climate Corporate Data Accountability Act (SB-253) and Climate-Related Financial Risk Act (SB-261), align with the proposed federal rules from the US Securities and Exchange Commission (SEC) and apply to many large companies operating in California.

SB-253 necessitates US firms with annual revenues exceeding $1 billion operating in California to disclose their Scope 1 and 2 greenhouse gas (GHG) emissions data beginning in 2026 and their Scope 3 GHG emissions data beginning in 2027. Scope 3 emissions include a wide range of indirect emissions, requiring data collection from third parties upstream and downstream.

SB-261 requires "covered entities" with annual revenues above $500 million doing business in California to publicly disclose climate-related financial risks based on TCFD recommendations. This disclosure encompasses vulnerabilities concerning employees, supply chains, consumer demand, and shareholder value.

These California laws differ from the SEC's proposed rules in several ways, including the requirement for Scope 3 emissions disclosure and the potential need for scenario analysis. They also apply to both public and private companies doing business in the state.

While legal challenges may arise, including constitutional arguments and potential First Amendment issues, the legislation represents a significant milestone in mandating GHG emissions and climate risk reporting, with potential penalties for noncompliance. Approximately 5,000 companies doing business in California may be subject to SB-253, and about 10,000 companies may fall under SB-261's purview.

Governor Newsom has expressed concerns about the feasibility and financial impact of these bills and plans to work with the legislature to address implementation issues in the coming year. These laws represent a significant step toward enhancing transparency, standardizing climate disclosures, and fostering climate action in California's business community.

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Additional Deloitte US perspective on climate risks

For additional insights, please see our ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy:

- *Deloitte 2023 CxO Sustainability Report*
- 2024 financial services industry outlooks
- Ingraining sustainability in the next era of ESG investing
- The CIO's call to action: Driving an environmentally sustainable tech agenda to accelerate organizational change
- Climate change and financial risk digest | Deloitte US
- Center for Regulatory Strategy - Sustainability, climate & equity | Deloitte US

Endnotes

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