Biden Administration Issues Executive Order on Climate-Related Financial Risks

June 8, 2021

Last month, President Biden issued an Executive Order (the "Order")[1] that directs federal agencies to take wide-ranging actions regarding climate-related financial risks. The Order aims to "advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk" across the federal government. It notes that these risks include both physical risks, such as supply chain disruptions from increased extreme weather, and transition risks, which result from a global shift away from carbon-intensive energy sources and industrial processes. The Order states that the failure of financial institutions to appropriately and adequately account for and measure these risks threatens U.S. companies, markets and financial institutions.

While the Order is directed to agencies across the federal government and will have wide-ranging implications for various sectors, there are particular directives that will be especially relevant for the banking industry. In particular, Treasury Secretary Yellen is directed to issue a report that assesses the efforts by Financial Stability Oversight Council ("FSOC") member agencies to integrate consideration of climate-related financial risks into their policies and programs and recommend actions for mitigating such risk, including through "new or revised regulatory standards." As discussed in our previous Debevoise In Depth, financial regulators are already becoming increasingly focused on addressing climate-related challenges.[2] The Order builds on this momentum and may result in greater consideration of various climate-related regulatory initiatives.

In this client update, we outline the aspects of the Order that are of particular relevance for the banking industry and discuss the potential implications for banking regulation.

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[1] The White House, Executive Order on Climate-Related Financial Risk (May 20, 2021), *available* here.

[2] *See* our previous Debevoise In Depth, Banks and ESG: Lessons from Climate Change-Related Initiatives, *available* here.

KEY COMPONENTS OF THE EXECUTIVE ORDER THAT WILL AFFECT THE BANKING INDUSTRY

- The Order directs Treasury Secretary Janet Yellen, as head of FSOC, to engage with FSOC members[3] in (i) assessing the climate-related financial risks, including physical and transition risks, to the financial stability of the federal government and stability of the U.S. financial system; and (ii) facilitating the sharing of climate-related financial risk data and information among FSOC member agencies and other executive departments and agencies.

- Treasury Secretary Janet Yellen is also tasked with issuing a report to the President within 180 days that assesses the efforts by FSOC member agencies to integrate consideration of climate-related financial risks into their policies and programs. The report must discuss:

    - the necessity of "any actions to enhance climate-related disclosures by regulated entities" and a recommended plan for taking such actions;

    - current approaches to incorporating climate-related financial risk into the agencies' respective regulatory and supervisory activities and any impediments faced in adopting those approaches;

    - recommended processes for identifying climate-related financial risk to U.S. financial stability; and

    - recommendations on how to mitigate climate-related financial risk, including through "new or revised regulatory standards."

- The Office of Financial Research and Federal Insurance Office are required to assist the Treasury Secretary and FSOC in assessing climate-related risks to financial stability. The Office of Financial Research must engage in data collection and research development on climate-related financial risks to the U.S. financial system. The Federal Insurance Office must address climate-related gaps in the supervision and regulation of insurers, focusing on the potential for major disruptions of private insurance coverage in high climate-risk regions in the United States.

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[3] FSOC is comprised of ten voting members and five nonvoting members. The voting members are: the Secretary of the Treasury who serves as the Chairperson, the Chairman of the Federal Reserve Board, the Comptroller of the Currency, the Director of the Bureau of Consumer Financial Protection, the Chairman of the Securities and Exchange Commission, the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Commodity Futures Trading Commission, the Director of the Federal Housing Finance Agency, the Chairman of the National Credit Union Administration, and an independent member with insurance expertise who is appointed by the President and confirmed by the Senate for a six-year term.

- The Treasury Secretary must include an assessment of climate-related financial risk in FSOC's annual report to Congress.

CURRENT CLIMATE ACTIONS BY BANKING REGULATORS

The language of the Order is not entirely unfamiliar or unexpected. In a speech to the Institute of International Finance at the end of April, Secretary Yellen highlighted the actions that the Treasury is and will be taking on climate.[4] In particular, she stated that FSOC will prioritize analysis of climate-related financial risks this year and coordinate approaches among regulatory agencies in understanding and addressing these risks. These comments came two days after the Treasury announced the creation of a Climate Hub that would coordinate climate-related initiatives across the Treasury Department.[5]

In addition, various banking agencies have already started to take action on climate issues of their own accord. At the end of last year, the Federal Reserve Board (the "FRB") incorporated climate analysis into its Financial Stability Report and its Supervision and Regulation Report. This year, it established two committees—the Supervision Climate Committee and the Financial Stability Climate Committee—responsible for identifying and addressing climate-related risks to supervised firms and financial stability, respectively. The Office of the Comptroller of the Currency (the "OCC") has also indicated that it will focus to a greater extent on the risks of climate change to banks and the financial system. For the first time, the OCC cited climate change risk in its semiannual risk report and stated that the agency is engaged on this issue both domestically and internationally.[6] Similarly, the Federal Deposit Insurance Corporation (the "FDIC") noted in its 2021 Annual Performance plan that it is conducting research into the potential impact of climate change on the financial sector.[7] At a House Financial Services Committee hearing with prudential regulators on May 19, 2021, both the Acting Comptroller of the Currency, Michael Hsu, and the Chairwoman of the FDIC, Jelena McWilliams, stated that their agencies expect banks to assess and manage climate-related risks to support the safety and soundness of the financial system.[8]

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[4] Janet Yellen, Secretary of the Treasury Remarks to the Institute of International Finance [hereinafter "Yellen Remarks"] (Apr. 21, 2021) *available* here.

[5] Press Release, Treasury Announces Coordinated Climate Policy Strategy with New Treasury Climate Hub and Climate Counselor (Apr. 19, 2021) *available* here.

[6] Office of the Comptroller of the Currency, Semiannual Risk Perspective (Spring 2021), *available* here.

[7] Federal Deposit Insurance Corporation, 2021 Annual Performance Plan, *available* here.

[8] *See* Michael Hsu and Jelena McWilliams Testimony at "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions," House Committee on Financial Services Hearing (May 19, 2021), *available* here.

IMPLICATIONS OF THE EXECUTIVE ORDER ON BANKING REGULATION

The Order may lead to greater consideration of various climate-related regulatory initiatives. While the Order does not go so far as to mandate corporate climate-related disclosures, Secretary Yellen has indicated the importance of consistency and reliability of climate-related disclosures, and Securities and Exchange Commission Chair Gary Gensler has stated that he expects to propose new rules on corporate climate risk disclosures this year.[9] Further, there may be increased debate on the viability of actions such as climate stress testing or scenario analysis, and integrating climate-risk into bank capital requirements.

It will also be important for financial institutions to keep an eye on international developments in order to understand how the regulatory landscape may evolve in the United States. While the Order is just the latest way in which the Biden administration aims to establish global leadership on climate change, it also reflects the administration's efforts to catch up to international initiatives and European regulators. Last year, the European Central Bank (the "ECB") released guidance for financial institutions to address climate financial risk.[10] Countries such as the United Kingdom and New Zealand have made climate risk reporting mandatory for financial institutions and large companies, using guidelines developed by the Task Force on Climate-related Financial Disclosures ("TCFD").[11] The ECB, Bank of England and counterparts in other jurisdictions have already started performing climate-based scenario analyses that assess the effects of climate-related risks on the financial system under a wide range of assumptions.

OTHER DIRECTIVES THAT MAY IMPACT BANKS AND THEIR CUSTOMERS

Finally, in addition to banking-specific directives, the Order includes directives to the federal government generally and directives that focus on economy-wide risks. For example:

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9 *See* Yellen Remarks; Gary Gensler Testimony at "Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III," House Committee on Financial Services Hearing (May 6, 2021), *available* here.

10 European Central Bank, Guide on climate-related and environmental risks, Supervisory expectations relating to risk management and disclosure, (May 2020), *available* here.

11 The TCFD was established by the Financial Stability Board in 2015 to develop consistent climate-related financial risk disclosures for businesses to use in providing information to stakeholders. The Final Recommendations by the TCFD were published in 2017. *See* Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures, Task Force on Climate-related Financial Disclosures (Jun. 2017), *available* here. In the past month, Australia and Singapore became the latest countries to establish climate disclosure practices that align with the TCFD guidelines.

- Within 120 days, the Biden administration must develop a government-wide strategy regarding (i) the measurement, assessment, mitigation and disclosure of climate-related risks to government programs, assets and liabilities; (ii) the financing needs associated with achieving the U.S. pledge to achieve net-zero greenhouse gas emissions by 2050; and (iii) areas in which private and public investments can assist in meeting these financing needs.

- The OMB Director and the Chair of the Council of Economic Advisers, in consultation with the Director of the National Economic Council, the National Climate Advisor and the head of other agencies as appropriate, are required to develop and publish an annual assessment of the U.S. government's climate risk exposure.

This whole-of-government approach to climate change could lead to increased regulation and enforcement of climate-related issues across a number of nonbanking industries. As such, financial institutions must consider not only requirements that may be imposed directly on them, but also additional regulation, scrutiny and enforcement in industries and sectors to which they are exposed.

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Please do not hesitate to contact us with any questions.

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