

# Clients & Friends Memo

## Financial Stability Oversight Council Issues Key Report Declaring Climate Change as an Emerging Threat to U.S. Financial Stability

October 25, 2021

On October 21, 2021, the [Financial Stability Oversight Council](#) (“FSOC”), established in 2010 by the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#) to respond to emerging threats to the stability of the U.S. financial system,<sup>1</sup> released a [Report on Climate-Related Financial Risk](#) (the “Report”).<sup>2</sup> The Report was published in response to President Biden’s [Executive Order 14030](#) (the “Executive Order”), which recognized that the “intensifying impacts of climate change present physical risk to assets, publicly traded securities, private investments, and companies—such as increased extreme weather risk leading to supply chain disruptions,” and established the policy of the Biden Administration to “advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk[;]” “act to mitigate that risk and its drivers, while accounting for and addressing disparate impacts on disadvantaged communities and communities of color[;]” and “achieve our target of a net-zero emissions economy by no later than 2050.” The Executive Order required the Secretary of Treasury, as the Chair of the FSOC, to issue a report on the FSOC’s activities to address climate-related financial risks.

In the Report, the FSOC declares climate change as an emerging threat to U.S. financial stability. The Report provides 30 recommendations to U.S. financial regulators to help mitigate that risk, focusing on four key initiatives:

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<sup>1</sup> The FSOC is comprised of ten voting members and five nonvoting members, who have financial regulatory experience, plus an independent insurance expert appointed by the President. *Financial Stability Oversight Council*, U.S. Dept. of the Treasury, <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc> (last visited Oct. 25, 2021).

<sup>2</sup> See also Press Release, U.S. Dept. of the Treasury, *READ OUT: Financial Stability Oversight Council Meeting on October 21, 2021* (Oct. 21, 2021), <https://home.treasury.gov/news/press-releases/jy0425>; FSOC, *FACT SHEET: The Financial Stability Oversight Council’s Response to Climate-Related Financial Risk* (Oct. 21, 2021), <https://home.treasury.gov/system/files/136/FACT-SHEET-The-Financial-Stability-Oversight-Councils-Response-to-Climate-Related-Financial-Risk.pdf>.

1. “Assess climate-related financial risks to financial stability, including through scenario analysis, and evaluate whether revised or new regulations or guidance is necessary to properly account for these risks[;]”
2. “Promote enhanced climate-related disclosures[;]”
3. “Enhance climate-related data to allow better risk measurement by regulators and the private sector[;]” and
4. “Build capacity. Analyzing all this information and coordinating the response among the Council’s member agencies requires more resources.”<sup>3</sup>

The FSOC will prioritize enhancing cooperation with international forums, addressing the needs of vulnerable populations, and building on existing climate change mitigation efforts.

The Report also announces the creation of a Climate-related Financial Risk Committee to facilitate coordination among FSOC members and the development of common approaches and standards. In addition, the FSOC formed a Climate-related Financial Risk Advisory Committee, which will focus on gathering data to help the FSOC address climate-related financial risks.

The Report did not recommend climate-related capital requirements for banks or limits on financing to fossil fuel companies, nor did it provide any specific timelines for regulators to act, which has been the subject of criticism from environmental groups.<sup>4</sup> A senior Treasury official noted, however, that the Report is “the first step, and we expect further action going forward” and that “[t]his is like the starting gun going off for the U.S. financial system.”<sup>5</sup>

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<sup>3</sup> Press Release, U.S. Dept. of the Treasury, *Remarks by Secretary Janet L. Yellen at the Open Session of the Meeting of the Financial Stability Oversight Council* (October 21, 2021), <https://home.treasury.gov/news/press-releases/jy0424>.

<sup>4</sup> Steven Mufson & Maxine Joselow, *Biden administration warns that climate change poses risks to financial system*, THE WASH. POST, October 21, 2021, <https://www.washingtonpost.com/climate-environment/2021/10/21/biden-administration-warns-that-climate-change-poses-risks-financial-system/>.

<sup>5</sup> See Press Release, Bd. of Governors of the Fed. Reserve System, *Statement of Chair Jerome H. Powell on the Financial Stability Oversight Council’s (FSOC) Report on Climate-Related Financial Risk* (October 21, 2021), <https://www.federalreserve.gov/newsevents/pressreleases/other20211021c.htm> (“Climate change poses significant challenges for the global economy and the financial system. The public rightly expects us to work to ensure the financial system is resilient to climate-related financial risks. We appreciate the magnitude of the challenges ahead of us and the Federal Reserve is committed to doing our part. I want to thank FSOC for their work on this comprehensive report, which I support.”); Press Release, SEC, Chair Gary Gensler, *Statement Before the Financial Stability Oversight Council* (October 21, 2021), <https://www.sec.gov/news/public-statement/gensler-statement-financial-stability-oversight-council-102121> (stating “I support this thoughtful and thought-provoking report discussing how climate risk could manifest and actions Council members are taking within the authorities and mandates[;]” and highlighting the SEC’s two “important” projects addressing climate risk

Each of the four key initiatives, while seemingly straightforward, are extremely complex.

- Scenario analysis, *i.e.*, understanding how the physical and transition risks and opportunities associated with climate change will impact a business over time depends on consideration of a host of inputs. These include choices of scenarios themselves, time horizons, supporting data, assumptions around technology development, resource usage, economic conditions, and the timing of potential impacts. Even taking into account that each business is unique, the level of judgment and discretion entailed in the enormous number of decisions that factor into scenario analysis, coupled with a lack of standardization of what that analysis should entail, necessarily raises questions regarding the extent, reliability, and accuracy of each company's analysis.
- To be useful to investors and regulators, climate change disclosure needs to be consistent, reliable, and comparable among companies and industries. As we previously have discussed, there are no mandatory or accepted global or U.S. standards for reporting material climate change issues.<sup>6</sup> Various frameworks do exist, and some, like those issued by the Financial Stability Board's Task Force on Climate-Related Financial Disclosures, appear to be gaining increasing traction among issuers. But the current state of play remains that wide disparities continue in the quality and thoroughness of climate change disclosure here and abroad.<sup>7</sup>
- With respect to climate-related data, a plethora of metrics are being issued by various institutions, but again, none has gained widespread acceptance. Examples include MSCI and Sustainalytics.<sup>8</sup>

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disclosures—the first dealing with public company disclosures and the second addressing naming funds such as “sustainable” or “green”).

<sup>6</sup> Jason Halper, *et al.*, “Investors and Regulators Turning up the Heat on Climate-Change Disclosures,” HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2021), <https://corpgov.law.harvard.edu/2021/10/04/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures/>.

<sup>7</sup> Henry Engler, *U.S. regulators seen developing ‘green taxonomy’ to provide guidance to financial firms*, REUTERS (JULY 14, 2021), <https://www.reuters.com/legal/transactional/us-regulators-seen-developing-green-taxonomy-provide-guidance-financial-firms-2021-07-14/>; Jean Eaglesham and Anna Hirtenstein, “ESG Disclosure Rules From Europe Challenge U.S. Fund Managers,” WSJ (Mar. 22, 2021), <https://www.wsj.com/articles/esg-disclosure-rules-from-europe-challenge-u-s-fund-managers-11616405401>; Press Release, SEC, Acting Chair Allison Herren Lee, *Public Input Welcomed on Climate Change Disclosures* (Mar. 15, 2021), <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>; Gabriel Rosenberg, Margaret Tahyar, and Betty Huber, “Commenters Weigh in on SEC Climate Disclosures Request for Public Input”, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2021), <https://corpgov.law.harvard.edu/2021/07/24/commenters-weigh-in-on-sec-climate-disclosures-request-for-public-input/>.

<sup>8</sup> Press Release, State Street, *State Street ESG Solutions Provides Risk Analytics Enabling Climate-related Risk Disclosures and Reporting* (Mar. 8, 2021), <https://newsroom.statestreet.com/press-releases/press-release-details/2021/State-Street-ESG-Solutions-Provides-Risk-Analytics-Enabling-Climate-related-Risk-Disclosures-and-Reporting/default.aspx>; Press Release, Blackstone, *Blackstone to Acquire Sphera, a Leading Provider of ESG Software, Data, and Consulting Services, From Genstar Capital for \$1.4 Billion* (July 6, 2021), <https://www.blackstone.com/press-releases/article/blackstone-to-acquire-sphera-a-leading-provider-of-esg-software-data-and-consulting-services-from-genstar-capital-for-1-4-billion/>;  

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[https://www.msci.com/documents/1296102/1636401/MSCI\\_ESG\\_Metrics\\_factsheet.pdf/eee531f4-bf23-4628-b6cc-](https://www.msci.com/documents/1296102/1636401/MSCI_ESG_Metrics_factsheet.pdf/eee531f4-bf23-4628-b6cc-)

One hope is that the upcoming United Nations COP26 Conference in Glasgow starting October 31 will facilitate advancing these issues via global cooperation and attention. But even with such cooperation, the areas highlighted by the FSOC Report will remain works in progress for the foreseeable future.

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