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Federal Reserve Vice Chair Addresses Climate-Related Financial Risks

Travis P. Nelson and Lara M. Rios*

This article discusses Federal Reserve Board Vice Chair for Supervision Randal K. Quarles' speech to the Venice International Conference on Climate Change, where he addressed two "foundational components" of the Financial Stability Board's recently issued Climate Roadmap: disclosures and data. Vice Chair Quarles' comments, coupled with the Climate Roadmap, are yet another indicator that national financial regulatory authorities are examining the impact that climate change may have on the financial services industry, as well as the role of regulatory authorities to ensure that institutions and industries are accurately disclosing climate-related risks.

Federal Reserve Board ("FRB") Vice Chair for Supervision Randal K. Quarles, who also is chair of the Financial Stability Board ("FSB"), gave a speech several months ago to the Venice International Conference on Climate Change, where he addressed two "foundational components" of the FSB's recently issued Climate Roadmap: disclosures and data.

BACKGROUND

The FSB is an international body that monitors and makes recommendations about the global financial system. On July 7, 2021, the FSB issued its Roadmap for Addressing Climate-Related Financial Risks (the "Climate Roadmap"). The Climate Roadmap supports international coordination as to climate-related financial risks in several ways, such as:

- Promoting relevant initiatives at standard-setting bodies, the Network for Greening the Financial System ("NGFS") and other international organizations;
- Presenting relevant ongoing and planned international work in one place, which is designed to help identify gaps to be covered by further work, limit overlap, and promote synergies;
- Sketching out how the FSB can serve as a forum for discussing cross-sectoral and systemic issues and agreeing on a way forward; and
- Providing input into broader international policy considerations by

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facilitating communication with the G20, G7, and the 26th United Nations Climate Change Conference ("COP26").

As part of the FRB and FSB's efforts toward achieving greater informed decision-making, transparency, as well as cross-border consistency, the FSB-sponsored Task Force on Climate-Related Financial Disclosures ("TCFD") "has led to greater recognition of the importance of climate-related financial risk and of comparable and reliable disclosure," according to Vice Chair Quarles. The TCFD has set forth four core elements to guide any framework for disclosures: governance, strategy, risk management, and metrics and targets.

QUARLES' STATEMENTS

Reflecting the consensus that a globally consistent baseline standard for climate-related disclosures is needed, Quarles noted: "Globally consistent and comparable entity-level disclosures by non-financial companies, banks, insurers and asset managers are increasingly important to market participants and financial authorities as a means of providing information needed to assess and manage risks." Among the additional trends identified by Quarles is "an important baseline that focuses on one-way materiality—or the financial risk that climate change could have on a particular entity—based on the TCFD recommendations. The majority of [the FSB's] membership are already using the TCFD recommendations as a baseline for their own requirements or guidance." In order to achieve greater cross-border consistency, international organizations are expected to develop additional international standards on climate-related reporting.

Quarles noted that in addition to disclosures, "international initiatives are needed to improve data quality and address data gaps, and ultimately to establish a basis of comprehensive, consistent and comparable data for global monitoring and assessing climate-related financial risks." Quarles' comments reflect the Climate Roadmap's focus on establishing "a basis of comprehensive, consistent and comparable data for monitoring climate-related financial risks globally." In order for industry and financial regulators to more thoroughly understand financial risks, Quarles noted that "better information is needed on the underlying physical risks, including the sorts of extreme weather events that pose greatest risks to the balance sheets of households, firms and financial institutions."

Quarles also noted that data gathered through increased climate-related financial reporting requirements will enable national regulatory agencies to more accurately monitor for supervisory risk. According to Quarles, "the FSB is exploring how to assess the degree to which climate-related risks might be transferred or amplified by different financial sectors, including the interdependence of banks and insurance firms."

TAKEAWAYS AND CONSIDERATIONS

Quarles' comments, coupled with the Climate Roadmap, are yet another very clear indicator that national financial regulatory authorities in the United States and globally are examining the impact that climate change may have on the financial services industry, as well as the role of regulatory authorities to at the very least ensure that institutions and industries are accurately disclosing climate-related risks. At the individual institution level, Quarles' foundational components of disclosure and data have already materialized. An increasing number of major financial institutions have offered deposit and credit products that target environmentally friendly enterprises and programs. Institutions are finding that it is not enough to merely market their traditional banking products and services as environmentally friendly, but that they must also have the data—and in many cases, independent review—to verify that the environmentally friendly banking products are actually fulfilling the climate-related goals for which the products were marketed.

In addition to the technical data and verification, institutions are also reviewing for possible supervisory scrutiny of their climate-related products and services. For decades, institutions have been mindful of the risk of potentially deceptive products in the consumer financial services space. With the growth in environmentally friendly products being marketed to institutional investors, many with substantial constituents that are sensitive to climate-related issues, increased attention is being given to the potential for deceptive marketing materials that are targeted to non-consumer customers. While many generally would not think of large institutional investors, funds, private equity groups, etc., as being in need of protection from deceptive marketing practices, in the area of climate change—where institutional customers are placing their deposits with financial institutions based on specific representations of climate-friendly products, and those customers are making representations to their own constituents as to their climate-related efforts—there is at least some risk of increased scrutiny over a financial institution's marketing practices for allegations of potentially deceptive statements and disclosures.

The Climate Roadmap and Vice Chair Quarles' speech are additional indications that financial institutions should integrate climate-change risks into their overall operational strategy in a manner that is mindful of institution-specific risk but that also has a global view.