INVESTMENT COMPANY INSTITUTE

MEMO# 33090

February 5, 2021

Summary of Brookings Event Featuring Larry Fink and Mary Schapiro

[33090]

February 5, 2021 TO: ESG Advisory Group
ESG Task Force
ICI Global Regulated Funds Committee
SEC Rules Committee RE: Summary of Brookings Event Featuring Larry Fink and Mary Schapiro

On February 2, 2021, Brookings sponsored the following event: "Climate change and financial market regulations: Insights from BlackRock CEO Larry Fink and former SEC Chair Mary Schapiro."[1] Below is a summary of the event.

Comments of Larry Fink

Mr. Fink observed that climate risk generally and the transition to a carbon-free economy are both investment risks. Because we are now seeing the foundations for better climate-related reporting by companies, including based on the Task Force on Climate-related Financial Disclosures (TCFD) framework and Sustainability Accounting Standards Board (SASB) standards, investors are able to better evaluate the climate-related risks of companies. Finance is better able to evaluate how climate risk (both physical and transition) impacts forward valuations of companies.

He highlighted concerns about the potential for public/private arbitrage if climate-related disclosure is limited to public companies. Addressing climate change at a societal level cannot be based solely on evaluating public companies—private companies and municipalities also should be considered. Requiring more transparency from public companies would give them another reason to stay or become private. In addition, in order to look better from a sustainability standpoint, a public company might sell off certain parts of its business to a private company. While that public company may look better from a sustainability standpoint, there would be no societal benefit from that transaction. He also noted that a global solution is needed to prevent arbitrage between countries.

He stated that he has heard concerns from public companies about potential liability associated with the disclosure of climate risks and suggested that, for a transition period, companies should not be at risk for incorrect reporting until there is some agreement around standards.

Mr. Fink also pointed out that as companies provide more disclosure, the ability to create sustainable indexes and portfolios will accelerate. He predicted a tectonic shift for index funds because the financial markets may be able to develop customized, sustainable indexes.

Comments of Mary Schapiro

Ms. Schapiro leads the Secretariat for the TCFD and is Vice Chair of the SASB Foundation Board. She provided a brief overview of the TCFD, which was created by the Financial Stability Board to develop a voluntary framework for disclosure by companies of climate-related risks and opportunities to better inform economic decision-making by investors, lenders, and insurers. The framework has been endorsed by 1800 organizations. Ten national governments have endorsed it, including four that have announced that they will make TCFD-aligned reporting mandatory. She noted that climate risk affects all types and sizes of governments and companies and that under SASB standards, 72 of the 77 covered industries are materially impacted by climate change.

She cited the need for standards and noted that TCFD, as a framework, is only a foundation for standards. Noting that the International Financial Reporting Standards (IFRS) works in 140 countries and US Generally Accepted Accounting Principles (GAAP) is used in the United States and a handful of other countries, she stated that standard-setters need to work towards creating standards that produce comparable, decision-useful information that does not disadvantage companies in a particular country.

She described climate risk in terms of both physical and transition risks. She described transition risk as including a change in market preferences away from high carbon assets. She offered the example of General Motors (GM), which has pledged to be carbon neutral in its operations by 2040 and to ramp up production of electric vehicles.[2] She observed that GM's action will put pressure on other car manufacturers to do the same, which will require refitting plants and other activities.

She discussed the SEC's 2010 guidance on climate risk, which the agency issued when she was its chair and in response to companies telling the SEC it had a role to play in overseeing climate risk.[3] She commented that the issues raised in the guidance are "by magnitudes" more important today.

She commended the Biden Administration's whole government approach to climate risk and highlighted the roles of the following agencies:

- Securities and Exchange Commission—regulates public company disclosure;
- Federal Reserve Board—has identified climate change as a near-term risk to financial stability and announced the creation of a Supervision Climate Committee;[4]
- Department of Treasury—will create a climate hub focusing on risks to the financial system and related tax policy;
- Commodities Futures Trading Commission—issued a September report on managing climate risk in the financial system;[5] and
- Department of Labor (DOL)—regulates retirement plans and their fiduciaries.

With respect to DOL, Ms. Schapiro commented that it needs to make clear that under ERISA consideration of climate-related factors in investment decisions is consistent—not inconsistent—with fiduciary duties.

She discussed the SEC's role and indicated that it has the following tools available to it:

- Creating disclosure standards to improve the quality and comparability of information in the marketplace (and she thinks they should do this and should also work with European and other regulators so that there is a global solution);
- Commenting on the adequacy of issuers’ climate risk disclosures;
- Working with the Public Company Accounting Oversight Board (PCAOB) to ensure auditors are competent to assess risks for climate change;
- Working with credit rating agencies to incorporate climate risk, where appropriate, in ratings; and
- Using the bully pulpit to set expectations on the quality and comparability of disclosures.

Ms. Schapiro emphasized that the SEC is a disclosure agency and that it does not have the authority to tell companies how to run their businesses, such as by requiring limits on greenhouse gas emissions. Legislation could create this type of obligation or the markets could demand it. She noted that banking regulators have more authority to put substantive limitations on the activities of banks if they are deemed necessary for systemic stability.

Ms. Schapiro noted that it is very important to prevent greenwashing because, if left unchecked, it could destroy confidence in the market for ESG products. She expects regulators to focus on preventing greenwashing. She also noted that the use of common terminology, such as taxonomies and definitions, can help protect customers.

She pointed out that a non-prescriptive Congressional mandate around disclosure could help the SEC withstand any legal challenge to any disclosure rules it might adopt but emphasized that the SEC has the authority now to mandate disclosure and could do so in short order.

Dorothy M. Donohue
Deputy General Counsel - Securities Regulation

Annette Capretta
Associate General Counsel

endnotes

[1] An archive of the 60-minute event is *available at* https://www.brookings.edu/events/climate-change-and-financial-market-regulations-insights-from-blackrock-ceo-larry-fink-and-former-sec-chair-mary-schapiro/.

[2] *See* General Motors, the Largest U.S. Automaker, Plans to be Carbon Neutral by 2040, *available at* https://media.gm.com/media/us/en/gm/home.detail.html/content/Pages/news/us/en/2021/jan/0128-carbon.html.

[3] *See* Commission Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106; 34-61469 (February 2, 2010), *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[4] *See* Federal Reserve Bank of New York Press Release (Jan. 25, 2021), *available at*

https://www.newyorkfed.org/newsevents/news/aboutthefed/2021/20210125.

[5] *See* CFTC, Managing Climate Risk in the U.S. Financial System (September 9, 2020), *available at* https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf.