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October 28, 2021

FSOC Issues Report on Climate-Related Financial Risk

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TO: ICI Members
Investment Company Directors
ICI Global Members
ESG Advisory Group
ESG Task Force SUBJECTS: Disclosure
ESG
Financial Stability RE: FSOC Issues Report on Climate-Related Financial Risk

On October 21, the Financial Stability Oversight Council (FSOC or Council) released a report on Climate-Related Financial Risk.[\[1\]](#) The report is the first time that the Council has identified climate change as an emerging and increasing threat to US financial stability and demonstrates the commitment of its members, which include the Securities and Exchange Commission (SEC) and other US financial regulators,[\[2\]](#) to addressing climate-related financial risks. The report aims at enhancing coordination across Council members. FSOC notes that its members are already taking actions that will help fulfill the Council's goals, but recommends further member action, including actions related to data gathering and disclosure.

This memorandum begins with a high-level roadmap to the 133-page FSOC report. It then briefly describes the report's findings and recommendations and highlights the remarks of SEC Chair Gary Gensler in connection with the Council's approval of the report.

Roadmap to the Report

- Chapter one discusses climate-related financial risks, a framework for how climate risks can increase risks to financial stability, and how the Council's approach to these issues is aligned with its core mission and statutory responsibilities.
- Chapter two reviews the work that is currently underway across the Council's members on climate-related financial risks and stability. The work of the SEC and other market regulators is discussed on pages 33-37.
- Chapter three highlights the data and methodological challenges associated with the measurement of climate-related financial risks, and potential approaches to solve

these challenges. Discussion specific to asset management can be found on pages 61 and 65.

- Chapter four discusses the value of consistent, comparable, and decision-useful climate-related disclosures for investors, financial institutions, regulators, and the public in measuring climate-related financial risks. Discussion specific to asset management can be found on pages 71-72.
- Chapter five presents key issues for assessing the effects of climate-related financial risks on financial markets and institutions, emphasizing the need for measurement tools to assess such risks. The report discusses the important role that scenario analysis can play in the development and deployment of these critical assessments while also recognizing the complexities and challenges associated with scenario analysis.
- Chapter six synthesizes the analysis contained in the report through a set of recommendations that begin to address the challenges and needs identified earlier.

Findings on Climate-Related Risks and Financial Stability

The report explains that climate-related financial risks can be grouped into two broad categories: physical risks and transition risks. Physical risks refer to the harm to people and property arising from acute, climate-related disaster events. Transition risks refer to stresses arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change.

FSOC warns that climate-related impacts in the form of warming temperatures, rising sea levels, droughts, wildfires, intensifying storms, and other climate-related events are already imposing significant costs upon the public and the economy. These changes will likely require technological innovations and complementary policy actions, which are likely to affect households, communities, and businesses. FSOC states that the impacts of both climate change and the adjustments necessary to reduce greenhouse gas emissions present risks, as well as opportunities, to the financial system.

The report notes that FSOC members already are taking action to address climate-related financial risks and working to improve the resiliency of the financial system to those risks. The Council believes, however, that policy responses must also take account of the externalities associated with greenhouse gas emissions, particularly the failure of market prices in the economic system to incorporate the cost of damages resulting from emissions. FSOC cautions that if appropriate policy actions are not taken by policymakers, the risks of both climate-related impacts to the financial system and of a disorderly transition will increase.

Overall, FSOC finds that there are "complex transmission channels linking transition and physical risks to the economy and financial sector." It sets forth a framework for the assessment of climate-related financial risks, given such complex transmission channels, including:

- Defining the climate change risks and how they may affect the financial sector,
- Quantifying the effect of climate risks on economic activity,
- Evaluating the links between economic impacts and financial risks, and
- Assessing financial stability.

FSOC Recommendations on Climate-Related Financial Risks

FSOC finds that the emerging threat to financial stability posed by climate change requires

its members to take action to expand capacity, improve data and measurement, enhance disclosure of climate-related risks, assess the scale of potential vulnerabilities, and make appropriate adjustments in regulatory and supervisory tools.

As a result, the report sets forth recommendations for the Council and its members to take action in response to climate-related risks in the following categories:

- Building capacity and expanding efforts to address climate-related financial risks,
- Filling climate-related data and methodological gaps,
- Enhancing public climate-related disclosures, and
- Assessing and mitigating climate-related risks that could threaten the stability of the financial system.

Each category is briefly summarized below. A list of all recommendations can be found in Box A on pages 5-9 of the report. The Council's fact sheet on the report says that the recommendations "will support the ongoing and urgent whole-of-government effort to address climate change, and help the financial system support an orderly, economy-wide transition to the goal of net-zero emissions."[\[3\]](#) The fact sheet further explains that the recommendations "will serve as a coordinated FSOC agenda, which [Council] members can implement in accordance with their respective mandates and authorities."

Building Capacity and Expanding Efforts to Address Climate-related Financial Risks

These recommendations aim to prioritize internal investments to expand Council members' respective capacities to define, identify, measure, monitor, assess, and report on climate-related financial risks and their effects on financial stability. These investments range from investing in staff to training to data modeling and monitoring. Notably, FSOC will form a staff-level committee, the Climate-related Financial Risk Committee, to prioritize issues and share information across FSOC members. FSOC will also form an advisory committee to help gather information from a broad array of stakeholders. In addition, the Council recommends that its members communicate their activities related to climate-related financial risks through annual or risk reports.

Filling Climate-related Data and Methodological Gaps

The Council recommends that its members identify and take appropriate steps towards ensuring that they have consistent and reliable data to assist in assessing climate-related risks. These recommendations urge Council members to perform internal reviews, develop consistent data standards, and implement appropriate data-sharing arrangements across FSOC and non-FSOC members consistent with confidentiality requirements.

Enhancing Public Climate-related Disclosures

FSOC recommends that its members take action for public reporting of climate related risks in a manner that builds on the core elements of the Task Force on Climate-Related Financial Disclosure (TCFD), to the extent applicable. The report calls on Council members to review their public disclosure requirements to promote consistent, comparable, and decision useful disclosure on climate-related risks and opportunities. FSOC particularly notes that the SEC staff is developing a proposal for public issuer disclosure requirements for climate-related risks, as well as evaluating disclosure requirements for registered funds and advisers on ESG factors.

Assessing and Mitigating Climate-related Risks to Financial Stability

The Council recommends that its members use scenario analysis as a tool for assessing climate-related financial risks, taking into account their supervisory and regulatory mandates and the size, complexity, and activities of regulated entities. The Council notes that its members can implement this recommendation in a variety of ways to achieve different goals and outcomes - for example, to evaluate regulated entities' risk management programs or to assess the impact of climate-related risks on the financial system as a whole.

SEC Chair Gensler Statement on the Report

SEC Chair Gary Gensler made remarks before the Council expressing his support of this report.^[4] He applauded the thoughtful report and the actions that Council members are taking within their authorities.

Gensler explained that he has asked the SEC staff to work on two important projects related to climate risk disclosure. The first focuses on public companies, with the aim of facilitating "consistent, comparable, and decision-useful" disclosures about climate risk. Gensler noted that [c]ompanies that are raising money from the public have an obligation to share full and fair information with investors on a regular basis."

Gensler also highlighted a second project focusing on funds that market themselves using "sustainable," "green," or like terms. Gensler stated that the SEC should consider updating its rules governing the naming of funds and enhancing disclosures to investors.

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endnotes

[1] See Financial Stability Oversight Council, [Report on Climate-Related Financial Risk](#) (October 21, 2021).

[2] Additional FSOC members include the Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, National Credit Union Administration, Office of the Comptroller of the Currency, Treasury Department, and Consumer Financial Protection Bureau.

[3] The fact sheet is available [here](#).

[4] See Chair Gary Gensler, [Statement Before the Financial Stability Oversight Council](#)

(October 21, 2021).

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