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White House Issues Roadmap to Address Climate-Related Financial Risk

The Report Presents the Biden Administration's Strategy for Addressing Climate-Related Financial Risk Across the U.S. Economy and Highlights Recent and Forthcoming Climate-Related Regulatory and Other Federal Government Initiatives

SUMMARY

On October 14, 2021, the White House issued a report entitled "A Roadmap to Build a Climate-resilient Economy."[1] The 40-page report was mandated by President Biden's May 2021 executive order on "Climate-Related Financial Risk" (the "EO")[2] and presents the Administration's "roadmap for measuring, disclosing, managing and mitigating climate-related financial risk across the economy," while "catalyzing public and private investment to seize the opportunity of a net-zero, clean energy future."[3] Guided by the five primary principles outlined in the report, the Administration's government-wide climate-risk strategy involves six main work streams:

- promoting the resilience of the U.S. financial system to climate-related risks;
- protecting life savings and pensions from climate-related financial risk;
- using federal procurement to address climate-related financial risk;
- incorporating climate-related financial risk into federal financial management and budgeting;
- incorporating climate-related financial risk into federal lending and underwriting; and
- building resilient infrastructure and communities.

Although the report largely discusses actions already contemplated by the EO, such as a forthcoming report by the Financial Stability Oversight Council ("FSOC") assessing climate-related financial risk and its impacts on the stability of the U.S. financial system, or previously announced regulatory initiatives, such as climate-

related disclosure rules expected to be promulgated by the Securities and Exchange Commission ("SEC"), the report demonstrates the Administration's continued focus on the physical and transition risks posed by climate change to the U.S. economy and financial system.

THE WHITE HOUSE REPORT

The report outlines five primary principles for addressing climate-related financial risk:

- mobilizing public and private finance to support the transition to a net-zero U.S. economy;
- protecting climate vulnerable and disadvantaged frontline communities;
- protecting against financial risk to the federal government and the communities it serves;
- safeguarding the U.S. financial system against climate-related financial risk; and
- demonstrating global leadership.

Based on these guiding principles, the report identifies the Administration's implementation strategy to address climate-related financial risk. This strategy involves efforts that track the six main work streams referred to above, each of which is discussed in more detail below.

Promoting the resilience of the U.S. financial system to climate-related financial risk

The report cautions that climate-related risks present a "uniquely complex set of risk management challenges" because climate change affects "a wide range of sectors, geographies and assets across the United States." Its complexity challenges "traditional notions of risk diversification," makes "historical patterns less useful for financial risk assessment and management" and will require the development and use of "forward-looking assessments." In light of these risks, the report stresses that the federal government, including financial regulators, has "critical responsibilities in safeguarding the U.S. financial sector and addressing climate-related risks to the economy." The report highlights several regulatory initiatives aimed at safeguarding the U.S. financial system against climate-related risks, including:

- ***Forthcoming FSOC report on climate-related financial risk and financial stability.*** The EO directs the Treasury Secretary, in her role as chair of the FSOC, to engage with FSOC members—including the heads of the federal banking regulators, the SEC, the Commodity Futures Trading Commission and the Consumer Financial Protection Bureau, among other financial regulators—to assess climate-related financial risk and its impacts on the stability of the U.S. financial system and to facilitate the sharing of relevant climate-related financial risk data among FSOC members. The report notes that, pursuant to the EO, FSOC will release a report by November 2021 discussing "the importance of climate-related disclosures by regulated entities, current approaches to incorporating climate-related financial risk into regulatory and supervisory activities, and recommended processes to identify climate-related financial risks to U.S. financial stability." The report further notes that the FSOC report is "the first step in a robust process of U.S. financial regulators developing the capacity and analytical tools to effectively assess and mitigate climate-related financial risks."
- ***Forthcoming Federal Insurance Office assessment of climate-related insurance risks.*** The EO instructs the Treasury Secretary to direct the Treasury Department's Federal Insurance Office ("FIO") to assess climate-related issues or gaps in the supervision and regulation of insurers (including as part of the FSOC's analysis of financial stability) and to further assess, in consultation with states, the

potential for major disruptions of private insurance coverage in regions of the country particularly vulnerable to climate change impacts. The report notes that, in August 2021, the FIO published a Request for Information to solicit public input on FIO's forthcoming work addressing climate-related insurance risks, which will focus on the two assessments mandated by the EO, as well as increasing regular engagement between the FIO and insurers on climate-related matters.[4]

- ***Forthcoming SEC climate-related disclosure rule*.** The report notes that the SEC is considering a mandatory disclosure rule for public issuers, which is expected to be proposed in the coming months and is intended to bring greater clarity to investors about the material risks and opportunities posed by climate change to their investments.[5]

Protecting life savings and pensions from climate-related financial risk

The report highlights, among other climate-related efforts by the Department of Labor ("DOL"), a recent DOL proposed rule, which would make it clear that employee benefit plan fiduciaries may consider climate change and other environmental, social and governance ("ESG") factors when making investment decisions and exercising shareholder rights.[6] According to the report, the proposed rule, if finalized, would bring the United States into close alignment with other countries, such as the United Kingdom, the European Union and Japan, which have already taken steps to incorporate climate change into retirement plan management. The report further notes that the DOL will submit a report to the President in November 2021 with an update on its efforts to address climate-related financial risk to retirement and pension plans.

Using federal procurement to address climate-related financial risk

The report notes that the federal government, as the world's largest purchaser of goods and services, has an obligation to be "a leader and model contracting partner," and that public procurement can "shift markets, drive innovation, and be a catalyst for new global standards." According to the report, the Federal Acquisition Regulatory (FAR) Council is exploring two amendments to the federal procurement regulations in order to better disclose and mitigate the risks climate change poses to federal contracting. First, the FAR Council is exploring an amendment to expand disclosure of greenhouse gas emissions in federal contracting and set science-based emissions reduction targets. Second, the FAR Council is considering requiring federal agencies to consider a supplier's greenhouse gas emissions when making procurement decisions and to give preference to bids from suppliers with lower emissions.[7]

Incorporating climate-related financial risk into federal budgeting and financial management

The report notes several initiatives to incorporate climate-related financial risk into federal budgeting and financial management, including steps being taken by the Office of Management and Budget ("OMB") and the Federal Accounting Standards Advisory Board to further develop robust climate-related risk assessment and disclosure requirements for federal agencies. In addition, the report notes that the President's budget for fiscal year 2023 will include an assessment of the federal government's climate-risk exposure and impacts on the long-term budget outlook, among other assessments.

Incorporating climate-related financial risk into federal lending and underwriting

The report highlights recent efforts by the Departments of Housing and Urban Development ("HUD"), Veterans Affairs ("VA") and Agriculture (the "USDA") to enhance their respective federal underwriting and lending program standards to better address climate-related financial risk to their loan portfolios, including the following:

- ***HUD lending programs.*** HUD and its agency partners will identify potential options to incorporate climate-related considerations into the policies and procedures for originating federally issued or guaranteed single-family mortgages. In addition, HUD will work with OMB, USDA and VA to ensure that government-supported mortgage programs are adequately and uniformly measuring climate-related financial and physical risks, while ensuring access to low- and moderate-income households. HUD is also in the process of finalizing rulemaking to allow for the use of private flood insurance with Federal Housing Administration ("FHA")-insured mortgages for properties in flood zones.[8]
- ***VA lending programs.*** VA is conducting a review of climate-related impacts on its home loan benefit program.
- ***USDA lending programs.*** USDA is working in collaboration with OMB, HUD and VA to identify and quantify the financial risk associated with climate change and to determine risk-mitigation strategies for the loan programs. The working group is initially focused on single-family loan programs, with the goal of applying the lessons learned across the entire range of loan programs.

Building resilient infrastructure and communities

The report outlines multiple federal agency and interagency initiatives that aim to improve the climate resilience of U.S. government facilities and operations, financial-sector critical infrastructure, and communities, including the Federal Emergency Management Agency's efforts to update its National Flood Insurance Program's standards to better align with the current understanding of flood risk and flood risk reduction approaches and the development by Treasury Department's Office of Cybersecurity and Critical Infrastructure Protection of a risk management program to analyze linkages between climate change-related risks and operational impacts to the financial sector.

CONCLUSION

The report outlines the Biden Administration's "whole-of-government" implementation strategy to address climate-related financial risk and indicates that financial regulators and the federal government will play an increasingly important role in the implementation of the Administration's climate-risk strategy. As the SEC, the financial regulators and other governmental agencies become increasingly focused on climate-related disclosures and financial risk management, companies, particularly SEC registrants, financial institutions (which will have responsibilities for their customers), and federal government contractors, should consider evaluating their existing approach to climate risks and opportunities and prepare to adapt to major climate-related regulatory and market developments in the coming years.

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ENDNOTES

[1] White House, *A Roadmap to Build A Climate-Resilient Economy* (October 14, 2021), available at https://www.whitehouse.gov/wp-content/uploads/2021/10/Climate-Finance-Report.pdf.

[2] *Executive Order 14030, Climate-Related Financial Risk* (May 20, 2021), available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk.

[3] Net-zero generally refers to a state where anthropogenic emissions of greenhouse gases to the atmosphere are balanced by anthropogenic removals over a specified period. *See*, *e.g.*, the definition of "net zero emission" on the website of Intergovernmental Panel on Climate Change (IPCC), available at https://www.ipcc.ch.

[4] *Federal Insurance Office Request for Information on the Insurance Sector and Climate-Related Financial Risks*, 86 Fed. Reg. 48814 (August 31, 2021), available at https://www.federalregister.gov/documents/2021/08/31/2021-18713/federal-insurance-office-request-for-information-on-the-insurance-sector-and-climate-related.

[5] The new rule is anticipated to be a major change from the SEC's existing principles-based approach, set out in its 2010 guidance on climate-risk disclosure, which does not mandate disclosure of any specific climate-related metrics and requires companies to disclose information about climate change's potential or actual impacts on the company to the extent material to the investors. See our Client Memorandum, date March 19, 2021, "SEC Focuses on Potential Updates to U.S. Climate Change Disclosure Requirements,", available at https://www.sullcrom.com/files/upload/SC-Publication-SEC-Updates-Climate-Change-Disclosure-Requirements.pdf.

[6] *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (Proposed Rule)*, 86 Fed. Reg. 57272 (October 14, 2021), available at https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights. The proposed rule follows the EO's direction and proposes to reverse two rules promulgated under the Trump Administration that have created a perception that fiduciaries are at risk if they include any ESG factors in the financial evaluation of plan investments.

[7] In October 2021, the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration published an advance notice of proposed rulemaking to seek public input on the proposed amendment to the federal acquisition regulation. *Federal Acquisition Regulation: Minimizing the Risk of Climate Change in Federal Acquisitions (Advanced Notice of Proposed Rulemaking)*, 86 Fed. Reg. 57404 (October 15, 2021), available at https://www.federalregister.gov/documents/2021/10/15/2021-22266/federal-acquisition-regulation-minimizing-the-risk-of-climate-change-in-federal-acquisitions.

[8] In November 2020, HUD published a proposed rule to amend FHA regulations to allow mortgagors the option to purchase private flood insurance on FHA-insured mortgages for properties located in Special Floor Hazard Areas. *Acceptance of Private Flood Insurance for FHA-Insured Mortgages (Proposed Rule)*, 85 Fed. Reg. 74630 (November 23, 2020), available at https://www.federalregister.gov/documents/2020/11/23/2020-25105/acceptance-of-private-flood-insurance-for-fha-insured-mortgages.

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