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CFTC Continues to Move Forward on Climate Change

On March 17, 2021, Acting Chairman of the Commodity Futures Trading Commission ("CFTC") Rostin Behnam, announced the establishment of a Climate Risk Unit to support the CFTC's mission of risk mitigation and price discovery by "focusing on the role of derivatives in understanding, pricing, and addressing climate-related risk and transitioning to a low-carbon economy." The Climate Risk Unit is a logical next step in the CFTC's efforts to tackle climate change risks and challenges, building on prior efforts which included the establishment of its Market Risk Advisory Committee's Climate-Related Market Risk Subcommittee and the commissioning of a report on Managing Climate Risk in the U.S. Financial System, which was issued in September 2020 (the "Report") (available here).

The Climate Risk Unit

The new Unit is intended to advance the role that the CFTC plays in the development of new risk management products and solutions by ensuring that they fairly facilitate hedging, price discovery, market transparency and capital allocation but also address climate change and the broader ESG risks and challenges. The CRU will seek to accomplish these goals through:

- research and ongoing market and stakeholder outreach;
- proactive engagement with the exchanges, clearing houses, industry groups and market participants regarding the impact of climate change risks and ways to address them;
- improved understanding by the CFTC of the types of derivatives and related products that can help mitigate climate change risks and assist with transitioning to a net-zero emissions economy;
- active participation in domestic and international efforts to create common standards, taxonomies, disclosures and practices for derivatives products and markets; and
- active support for the development of climate-related market risk data resources, tools, products and services.

The Report

The Report, the first of-its-kind by a U.S. government agency, examined the impact of climate change on the stability of the U.S. financial system and its ability to sustain the U.S. economy. The Report concluded that climate change does pose a risk to the U.S. financial system, that those risks may also exacerbate financial system vulnerabilities that have little to do with climate change and that financial regulators must recognize the risks posed and move to measure,

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understand and address those risks. The Report set out 53 wide-ranging recommendations for addressing and managing the risk and opportunities of climate change, including among others:

- incorporating climate-related risks into mandates of all relevant federal financial regulatory agencies;
- requiring banks and non-bank financial firms to address climate-related financial risks through their existing risk management frameworks;
- launching a pilot climate risk stress testing program;
- integrating climate risk into balance sheet management and asset purchases by financial authorities;
- support for the development of U.S.-appropriate standardized and consistent taxonomies for physical and transition risks, exposure, sensitivity, vulnerability, adaptation and resilience in order to define core terms supporting the comparison of climate risk data and associated financial products and services. To develop this guidance, the United States should study the establishment of a Standards Developing Organization (SDO) composed of public and private sector members;
- support for the clarification by financial regulators on the definition of materiality for purposes of disclosing medium- and long-term climate risks, including through quantitative and qualitative factors;
- review and update the Securities and Exchange's ("SEC") 2010 Guidance on climate risk disclosure and possible rulemaking to ensure implementation of the Guidance;
- require listed companies to disclose Scope 1 (direct emissions from owned or controlled sources) and Scope 2 (indirect emission from purchased energy generated by external entities) emissions, and as Scope 3 (all other indirect emissions across the value chain, including both upstream and downstream) transition risk metrics and consistent methodologies are developed, financial regulators should require their disclosure, to the extent material;
- integrate climate risk into U.S. fiscal policy, particularly for economic stimulus activities covering infrastructure, disaster relief, or other federal rebuilding;
- establish climate finance labs or regulatory sandboxes by financial regulators to enhance the development of innovative climate risk tools; and
- the CFTC should coordinate with other regulators to support the development of a robust ecosystem of climate-related risk management products.

The Journey Continues

The acting heads of both the SEC and the CFTC are engaging in a substantive way on climate change, in parallel with various other government agencies. The pace is likely to continue as the Biden administration's whole-of-government approach to climate issues gains further traction. The Report captures both the breadth of the issues to be addressed and the magnitude of the agenda. Ultimately, many of these actions will need to be considered in the context of global efforts.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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