Evergreen
Collaborative

Preventing a Climate Crash

5 Tools the Next President Can Use to Stop Wall Street from Financing the Climate Crisis, and Prevent the Next Economic Crash

October 2020

Introduction

Climate change threatens the stability of the United States and global financial systems—and, in turn, taxpayers, retirement savers, and working families who bear the overwhelming brunt of a financial crisis. And yet, Donald Trump and his administration continue to double down on climate denial and inaction. When a new president takes office in 2021, he will need to do more than roll back hundreds of Trump's executive actions that deregulate and gut climate protections. Simply returning to the 2016 status quo will not solve the 2021 climate crisis. The new president must embrace a national mobilization to defeat the climate crisis, which includes investing in growing a green economy, increasing employment and equity, protecting natural resources and utilizing financial tools to rein in climate risk.

Climate change will destroy the physical underpinnings of the economy — and will have the earliest and most devastating impact on the economic security of working families and communities of color. And as the economy responds by making long-overdue shifts away from fossil fuels, transitions in business models among laggard companies can disrupt traditional investment and financing strategies. The faster we take action to secure the stability of the financial sector, the faster we will protect the security of workers' retirement savings, and the economic well-being of every American. Bold action is needed — both to limit the contributions that the financial sector is making to climate risk through financing greenhouse gas pollution and to increase the resiliency of the financial system in the face of climate change.

Currently, America's financial system is picking winners and losers: fossil fuel companies are the winners and clean energy is losing. Since the Paris Agreement, the world's largest investment banks have financed more than $2.6 trillion in fossil fuel-related investments. Over 7,000 oil, gas, and petrochemical companies received between $3 and $7 billion from the Small Business Administration's Paycheck Protection Program (PPP), according to a recent analysis, despite those same firms experiencing heightened credit risk and contributing to environmental harm. All the while, the clean energy industry has lost more than 600,000 jobs. One analysis showed renewable wind and solar companies received a paltry $85 and $188 million from the PPP program.

Over the past dozen years, America has seen the catastrophic economic impact of excessive risk in the system and of external events: from the derivatives-driven recession of 2007-2008 to the coronavirus-driven recession of 2020. The next recession is likely to combine both the factors of risk and external events. Unless the next president acts quickly, America could stand on the brink of a climate recession.

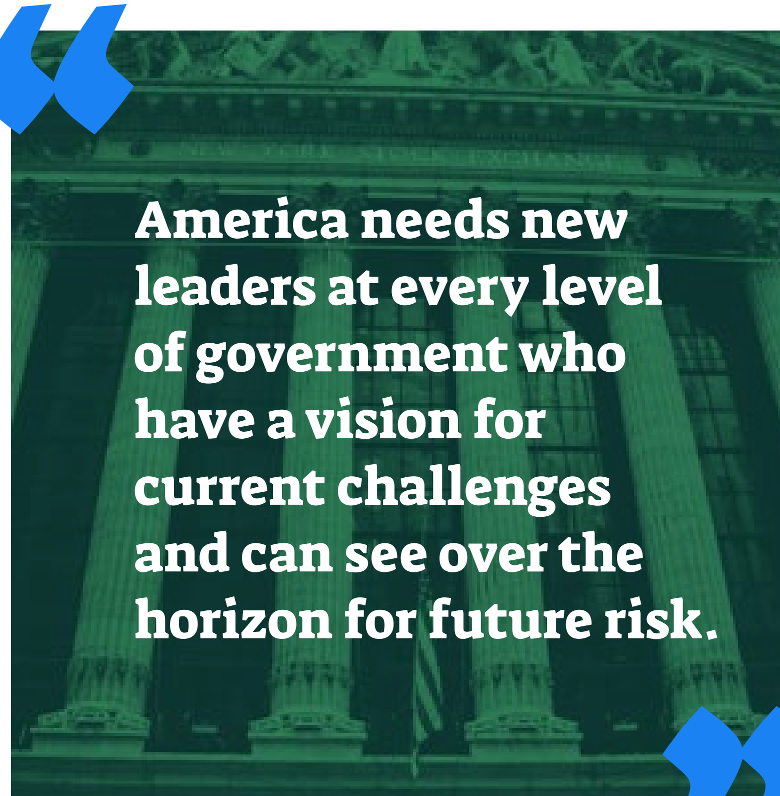
The next president and administration must use its powers to rein in climate risk to our financial system. Here are five steps they can take that do not require new legislation or new authority, starting on day one.

I. Personnel Is Policy: Appoint Financial Regulators Who Will Aggressively Use Their Authority to Take on Climate Risk

Americans have seen the results when President Trump hires fossil fuel and Wall Street executives to run the government: they put their profits ahead of the health of people and our planet. America needs new leaders at every level of government who have a vision for current challenges and can see over the horizon for future risk. The next administration must embrace a national mobilization on climate action, which includes understanding all of the ways finance fuels climate change, and all of the ways climate change is a risk to our financial system, economy, and working families.

Good policy starts with the people in charge. America needs financial regulators who are not afraid to stand up to Big Oil and their banking allies, and a Treasury Secretary who understands the implications of climate risk to the financial system and who is prepared to act quickly. In 2022, when the next president will choose a new Federal Reserve Chair, they must appoint someone who will prioritize climate action. America needs leaders at all federal financial agencies — including the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Federal Housing Finance Authority, and more — plus state and local financial regulators and finance offices, to fully account for and address climate risks. The next president must select financial leaders who share the understanding of climate risk and show willingness to act to remove it from the system.

America must be prepared for climate change at every level of its financial system. A range of regulatory actions will be needed to ensure that banks, insurance companies and asset managers and every publicly traded company—and large private pools of capital as well—will measure, report, and actively mitigate direct and financed emissions and other climate risks, and drive consistency, oversight, and compliance. The next administration can start by ensuring that leaders of every public institution are ready to prioritize climate action.



II. Work With International Allies to Build a Stronger, More Resilient Financial System

Every major country in the world embraced the Paris Climate Agreement in 2015; now, it's time for coordinated action for our global financial system. But as a recent Ceres report made clear, the United States is badly lagging. While the European Union has set forth an ambitious climate and financial regulatory agenda, and the European Central Bank is boldly incorporating climate concerns into its monetary policy considerations, the United States has idled. This leaves the American financial system at risk. America must step up and become a global leader in addressing climate risk in the financial system.

In the absence of federal leadership, U.S. firms are joining international allies through partnerships like the Dutch-led Partnership for Carbon Accounting Financials (PCAF), which now represents more than $13.8 trillion in assets on behalf of 60 banks, insurance companies and investors — including both Morgan Stanley and Bank of America. In addition to partnerships like PCAF, decarbonization pathways are being developed through creative sectoral partnerships between lenders, operating companies, and customers to drive change sector-wide around the globe. And international research networks like Inspire share knowledge around implications of climate, financial regulatory, and monetary policy to support climate action.

But voluntary, ad hoc partnerships are not enough. U.S. regulators need to lead. The next administration should take an active role in recognizing climate risk to the financial system and work to become a leader in the global effort to decarbonize the financial sector. For example, the United States should immediately join the Network on Greening the Financial System (NGFS), a global coalition of central banks that was formed in 2017 and now has 69 members across five continents. The United States should support, rather than stymie, efforts by the Financial Stability Board, the International Organization of Securities Commissions, and other financial regulatory coordinating bodies to incorporate climate risk into their recommendations. U.S. leadership will play a pivotal role in determining whether action or delay carries the day.

III. Drive Transparency and Accountability Among Corporations and the Financial Sector for Climate-Related Risks

Publicly traded companies have a responsibility to disclose important business-related information to their shareholders. But right now, most U.S. companies do not share much information about their vulnerabilities or contributions to climate change, nor how these decisions affect their business, shareholders, or investors. In fact, the Trump administration has actively encouraged investors *not* to consider environmental, social, and governance (ESG) factors when making financial decisions. The administration has even proposed rules to stymie their choice about whether to do so. This isn't just about burying one's head in the sand; it's affirmatively bailing out the worst fossil fuel companies and climate laggards, and putting American businesses, investors, and pensioners at further risk of climate change, retirement insecurity, and a financial crisis. The next administration should clarify that considering ESG factors is not only fully consistent with a financial manager's fiduciary duty, but indeed essential to it.

Senator Elizabeth Warren (D-MA) and Rep. Sean Casten (D-IL) introduced a bill to require the Securities and Exchange Commission (SEC) to implement standardized climate risk disclosure. This bill is an important and necessary first step, but the next administration doesn't need to wait for Congress to act — because the SEC already has authority to take action on its own. The SEC should promulgate rules mandating climate risk disclosure — including for emissions being financed by firms and assets managed by firms, as well as for the financial sector overall. The commission should then utilize guidance, staff oversight, and enforcement to secure full compliance and high-quality comparability.

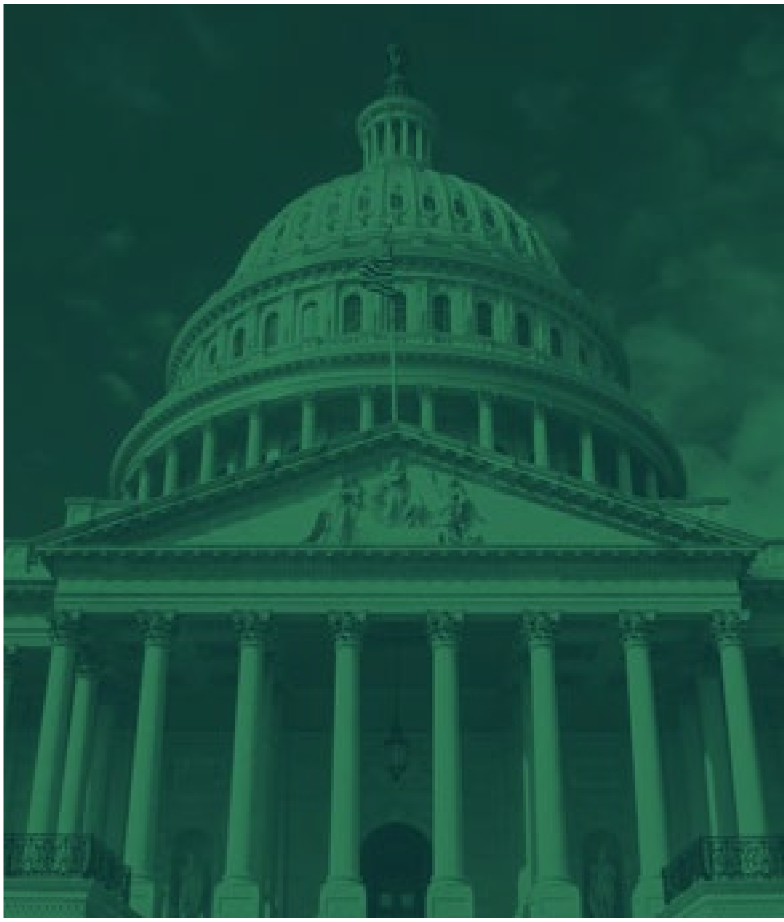
Climate disclosure must account for both the risk climate change poses to financial institutions and information about what greenhouse gas pollution institutions are financing. For example, a recent report from the Rainforest Action Network found that since 2016 alone, global banks have poured over $2.7 trillion into propping up fossil fuel projects (and this is likely an undercount because it captures only private data). Disclosing how U.S. banks, insurance companies, and asset managers finance carbon emissions is an important step to enable investors and the public to understand how deeply tied our financial institutions are to fossil fuel infrastructure, to allow investors to exercise shareholder rights, and to adequately prepare for the worst effects of climate change across the financial system.

IV. Use Dodd-Frank for What it Was Intended to Do—Reduce Risk

Disclosure is powerful, but it should not be the only tool deployed to reduce the threat of a climate-related crisis. After the 2008 financial crash, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act to ensure that the American financial system has necessary limits and regulatory protections to avoid the self-serving risky behaviors that lead to devastating crashes. Now, financial regulators should once again invoke the authority already granted to them under Dodd-Frank to actively prepare for and mitigate future climate-related shocks.

As a first step, the Financial Stability Oversight Council (FSOC), a body created by Dodd-Frank, should bring together heads of financial regulatory agencies with the specific intention of assessing and mitigating climate threats across jurisdictions and markets. The FSOC should then issue a public report on how climate change is a "systemic risk" to the U.S. financial system. Regulators should then develop actionable plans to address climate risks in their respective jurisdictions. In particular, the Federal Reserve should require climate stress tests for America's largest financial institutions. The Fed should also press these institutions for decarbonization strategies, and, as explained by a recent Financial Watch report, integrate climate risk into risk-weighted capital requirements to bolster the climate resilience of the financial system. Given that risks can originate or migrate outside of the core banking system, regulators should also deploy regulatory tools aimed at non-bank financial firms.

Dodd-Frank delivered powerful tools that can dramatically change behavior at the center of America's financial system; now it's time to put those tools to use. Failure to act on known risks is deeply harmful — we do not want to repeat 2008 in an even more deadly climate context, now made worse by a pandemic-fueled economic crisis.

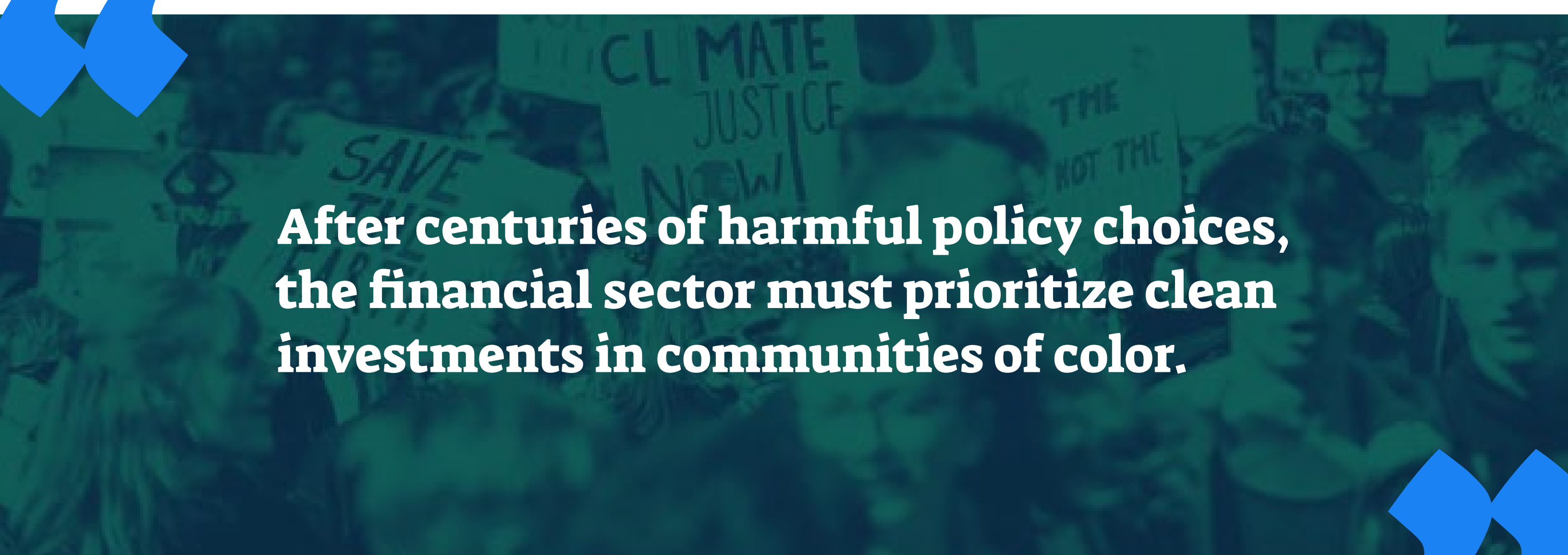


V. Drive Financial Sector Clean Energy Lending and Investment to Communities in Need

Communities of color are often hit the hardest by a financial crisis. These communities already face a wealth gap, disproportionate exposure to toxic pollutants, the extraordinary abuses of the 2008 financial crisis and scandals, heightened vulnerabilities to climate risk, and, most recently, a disproportionate burden from COVID-19. After centuries of harmful policy choices, the financial sector must prioritize clean investments in communities of color.

As a first step, financial regulators should evaluate whether financial firms, including government-sponsored enterprises, are serving their communities in a just and equitable manner. Additionally, financial regulators should ensure strong consumer protections are in place so that consumers have recourse if and when they face unfair and inequitable banking practices. And credit unions, community banks, and community development financial institutions (CDFIs) should be encouraged to facilitate clean energy lending in communities that have traditionally borne the brunt of climate change.

Financial regulators should also demand that financial sector boards and executive management have the requisite expertise to prioritize climate and community justice concerns. This should be reflected in board diversity, as well as board attention to achieving new and existing climate and community justice goals.



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Conclusion

The United States must take steps to stabilize the financial system in the face of climate risk and go further by limiting the role the financial system plays in financing the climate crisis. Fortunately, there are already significant tools available to catalyze systemic change. Financial regulators, and the next president of the United States, must simply be willing to act. The economic well-being of all current and future Americans depends on it.

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