President Biden Signs Executive Order on Addressing Climate Change Risk through Financial Regulation

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Editor's note: Andrew Olmem, J. Paul Forrester, and Thomas J. Delaney are partners at Mayer Brown LLP. This post is based on their Mayer Brown memorandum.

On Thursday, May 20, 2021, US President Biden signed an Executive Order, entitled "Climate-Related Financial Risk" (Climate Risk EO), that sets the stage for the US federal government, including its financial regulatory agencies, to begin to incorporate climate-risk and other environmental, social and governance (ESG) issues into financial regulation. The Climate Risk EO further demonstrates the priority the Biden administration is giving to addressing climate change and will likely accelerate ongoing efforts by federal financial regulators to adopt new, climate risk-related regulations. Of particular note, the executive order directs Treasury Secretary Janet Yellen to utilize the Financial Stability Oversight Council (FSOC) to coordinate the adoption of regulatory measures to address climate change on the part of the federal financial regulatory agencies. The US Securities and Exchange Commission (SEC) is already actively preparing a proposal to revise public company disclosure requirements to cover a range of ESG issues,[1] and the Federal Reserve Board has established two working committees to examine the climate-related risks to financial stability and to the safety and soundness of financial institutions.[2]

From the scope of the Climate Risk EO, it is evident that the administration believes that improved corporate disclosures on ESG are an important initial response to the risks posed by climate change, but that far broader regulatory reforms are likely over the next several years. The Climate Risk EO provides the policy framework for federal agencies to adopt new supervisory and regulatory measures with respect to not only insured depository institutions, but also insurers and other nonbank financial institutions, ERISA plans, the Federal Thrift Savings Plan (TSP), federal lending programs (US Department of Agriculture (USDA), US Department of Veterans Affairs (VA), Federal Housing Administration (FHA), and Ginnie Mae) and federal contractors. In addition, Secretary Yellen stated in her remarks on the signing of the Climate Risk EO that "[a]ssessments of climate-related financial risks may require new perspectives and new tools."[3] She did no go on to elaborate what additional tools may be under consideration.

The Climate Risk EO requires the submission of several reports to the president on additional regulatory measures that may be needed to address climate change risk. When these reports are

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[1] Discussed in more detail in our related March 9, 2021, Legal Update "US SEC Announces the Creation of a Climate and ESG Task Force."

[2] Discussed in more detail in our related March 26, 2021, Legal Update "US Federal Reserve Announces New Climate Committee and Provides More Guidance on Its Approach to Addressing Climate Change Risks."

[3] https://content.govdelivery.com/accounts/USTREAS/bulletins/2da3fca.

released later this year, they could provide more insights into what additional measures with respect to the financial system the administration believes are needed to address climate change risk.

A detailed summary of the Climate Risk EO is provided below.

Summary of Executive Order on Climate-Related Financial Risk

The Climate Risk EO establishes that it is the administration's policy to:

- "advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk …, including both physical and transition risks";
- "act to mitigate that risk and its drivers, while accounting for and addressing disparate impacts on disadvantaged communities and communities of color… and spurring the creation of well-paying jobs"; and
- "achieve our target of a net-zero emissions economy by no later than 2050."

The Climate Risk EO seeks to implement this policy by directing several senior administration officials to take specified actions.

1) White House. The Director of the National Economic Council (Brian Deese) and the National Climate Advisor (Gina McCarthy) are directed to develop a "comprehensive, Government-wide strategy" that includes:

- How to measure, assess, mitigate, and disclose the climate-related financial risks to the "federal government programs, assets and liabilities";
- The financing needed to achieve net-zero greenhouse gas emissions for the US economy by 2050 and limiting global average temperature rise to 1.5 degrees Celsius; and
- Where private and public investments can help provide the needed financing, while "advancing economic opportunity, worker empowerment, and environmental mitigation, especially in disadvantaged communities and communities of color."

The report is due within 120 days from the date of issuance of the Climate Risk EO (September 20, 2021).

2) FSOC. Treasury Secretary Janet Yellen is directed to use her position as chair of the FSOC to "engage with FSOC members" to assess the climate-related financial risks to the financial stability of the US and the federal government (including physical and transition risks) and facilitate the sharing of climate-related financial risks data and information among FSOC member agencies and other government departments and agencies.

The Climate Risk EO also requests that FSOC issue a report to the president on the actions by FSOC member agencies to integrate climate-related financial risk in their policies and programs, including climate-related disclosures by regulated entities, regulatory and supervisory activities, and processes for identifying climate-related financial risk to the financial stability of the United States. The report will contain recommendations on how climate-related financial risk can be mitigated, including through regulatory standards. The report is due 180 days from the date of the issuance of the Climate Risk EO (namely, November 20, 2021). Secretary Yellen also is directed to include an assessment of climate-related financial risks in the FSOC's annual report to Congress.

3) Federal Insurance Office. The Climate Risk EO directs Secretary Yellen to have the Federal Insurance Office assess the climate-related gaps in the supervision and regulation of insurance companies and to assess the risks that climate change will create major disruptions in private insurance coverage in any regions of the country.

4) Office of Financial Research. The Climate Risk EO also directs Secretary Yellen to have the director of the Office of Financial Research (OFR) to assist the FSOC in assessing and identifying climate-related financial risks to financial stability, including by using its authority to collect data. The director of OFR will also develop research on climate-related financial risk to the US financial system.

5) Secretary of Labor.

a. **ERISA.** The Climate Risk EO directs the Secretary of Labor (Marty Walsh) to determine what actions can be taken under the Employee Retirement Income Security Act (ERISA) to protect the savings and pensions of Americans from climate-related financial risk. It also directs Secretary Walsh to consider suspending, revising, or rescinding the US Department of Labor's regulations "Factors in Selecting Plan Investments" and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," which were issued last year to establish that ESG factors should not be considered by ERISA fiduciaries in their investment decisions and proxy voting if they have an adverse impact on the pecuniary interests of plan beneficiaries. It is likely that Secretary Walsh will issue new regulations that explicitly allow ERISA fiduciaries to consider ESG factors in investment decisions and proxy voting.
b. **TSP.** The Climate Risk EO directs Secretary Walsh to assess how the Federal Retirement Thrift Investment Board has used ESG factors in its investment decisions for the TSP.
c. **Report.** Secretary Walsh is to report to the president on the actions he has taken with respect to the aforementioned directives on ERISA and TSP within 180 days (namely, by November 20, 2021).

6) Office of Management and Budget (OMB). The Climate Risk EO directs the director of OMB (Acting Director Shalanda Young) and the National Economic Council director to develop recommendations for the National Climate Taskforce on how to integrate climate-related financial risk into federal financial management and report (particularly for federal lending programs), including through new accounting standards for federal financial reporting. Acting OMB Director Young is also directed to identify the climate-related financial risks to the federal government, develop methods to quantify that risk as part of the president's budget projections, and take steps to reduce that risk when formulating the president's budget and implementing the federal government appropriated budget. The OMB director and the Chair of the CEA (Cecilia Rouse) are directed to include annually an assessment of the federal government's climate risk exposure in the president's budget.

7) FARC. The Federal Acquisition Regulatory Council (FARC) is directed to consider amending the Federal Acquisition Regulation (FAR) to require major federal government contractors to not only disclose greenhouse gas emissions and climate-related financial risks, but also to set emission-reduction targets. FARC also is directed to consider climate change risk in its procurement decisions, giving preferences to contracts with lower emissions.

8) Federal Lending Programs. The executive order directs Secretaries of Agriculture (Tom Vilsack), Housing and Urban Development (Marcia Fudge) and Veterans Affairs (Denis McDonough) to consider how to incorporate climate-related financial risk into the operations of their respective lending programs, which include the loans and guaranties offered by FHA, VA, USDA and Ginnie Mae. These actions could include revising underwriting standards, loan terms and conditions, asset management and servicing. The Climate Risk EO also reestablishes the Federal Flood Management Standards, which were revoked by a prior executive order in August of 2017.