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ESG: An immediate priority of the new Administration

ESG is a priority across all financial services companies given the new Administration, investor, board, employee, customer, and quickly expanding regulator attention. Companies must move quickly in their growth strategy and their integrated risk management execution in order to strengthen ESG stewardship and corporate position, inclusive of sustainable finance and investment. KPMG is actively assisting companies with their ESG efforts – please see below for recent regulatory activity and next steps that financial service organizations should take now to advance their ESG program and standing.

Key points

— The new Administration has identified two aspects of ESG, climate and racial equity, as “immediate priorities” and through executive action has prompted a review of federal agency policies both internally and directed toward supervised entities.

— Appointees to cabinet level positions and department and agency leadership support and reinforce this commitment to ESG, and again, especially issues of climate and racial equity; agency leadership will be instrumental in promoting ESG within existing risk management and governance frameworks.

— Many rulemakings from the previous Administration that might serve to inhibit consideration of ESG issues will be caught up in the executive actions to halt or delay “midnight regulations” or may be subject to review and possible rescission under the Congressional Review Act.

— Financial services regulators are beginning to acknowledge and focus on issues related to capturing financial risks of climate change, including standardized disclosure, data availability, risk management (by supervisors and institutions), and international cooperation/coordination.

— Efforts to address racial equity generally address diversity, human capital disclosure, fair access/fair treatment, community support, and continuity of operations.

Administration updates

Executive Orders. A host of executive orders reinforce the new Administration’s commitment to ESG-related issues, and climate and racial equity in particular. These orders, which will directly and/or indirectly impact the broader financial services industry (regulators, companies, customers), include:

— **Climate**
  
— Establishing climate change as a foreign policy and national security priority.
Implementing a Government-wide approach to climate, including creating a new White House Office of Domestic Climate Policy, a National Climate Task Force, a White House Environmental Justice Interagency Council, and a White House Environmental Justice Advisory Council.

Pausing new oil and gas leases on public lands and waters.

Creating “environmental justice” for communities disproportionally impacted by climate change.

Requiring an accounting for the social costs, or monetized damages, associated with greenhouse gas emissions when analyzing regulatory and other relevant agency actions; metrics to be finalized by January 2022 by a new Interagency Working Group.

Rejoining the Paris Climate Agreement and achieving net-zero emissions by 2050.

**Racial equity**

- Directing HUD to mitigate racial bias in federal housing policies, and specifically to review the effects of its recent (2020) final rules addressing “Affirmatively Furthering Fair Housing” (AFFH) and disparate impact.
- Modernizing regulatory review to “promote public health and safety, economic growth, social welfare, racial justice, environmental stewardship, human dignity, equity, and the interests of future generations.”
- Assessing potential barriers to providing underserved communities with equal access to agency policies and programs as well as identifying methods to assess equity with respect to race, ethnicity, religion, income, geography, gender identity, sexual orientation, and disability.

**Regulatory updates**

Regulatory activity since the November 2020 election suggests an increasing ESG-related agenda:

- **CFPB.** Acting Director David Uejio outlined new priorities for the CFPB in 2021, including:
  - Immediately focusing on supervision and enforcement of companies responsible for COVID-19 relief (e.g., servicers, PPP lenders), including “aggressive action to ensure that regulated companies follow the law and meet their obligations to consumers” (e.g., forbearance, loan mitigation) and also expediting enforcement investigations relating to COVID-19.
  - Elevating and expanding existing investigations and exams, and adding new ones, to address racial equity, placing top priority on fair lending enforcement as well as identifying and rooting out unlawful conduct that disproportionately impacts communities of color and other vulnerable populations.

- **SEC.** The SEC adopted amendments to its Regulation S-K disclosures (Management’s Discussion and Analysis and other Financial Disclosures) on multiple occasions in 2020 but never directly addressed disclosures on climate risk or diversity. At the time, now Acting Commissioner Allison Herren Lee published public statements outlining her reasoning for dissenting to the rulemakings, including the omission of disclosures for climate risk and diversity, increasing investor assessments of individual customers. (Notably, OCC has now separately paused publication of this rule.)

- **SEC final rule on shareholder proposals,** which increases the amount and length of ownership necessary for a shareholder’s proposal to be considered in a company’s proxy statement, and also the amount of support needed for resubmission if the proposal is not approved.

- **DOL final rules related to retirement plan fiduciaries and ESG investments,** which directs plan fiduciaries to choose investments based on financial considerations rather than to promote non-financial objectives such as environmental, social, or public policy goals.

- **HUD final fair housing rules related to AFFH and disparate impact.** The subject of an executive order, these rules repeal a 2015 AFFH rule governing certifications and revise the burden-shifting test for determining discriminatory effect, respectively.
demand for comparable metrics on these specific issues, and limitations associated with a principles-based approach (which was advocated by the former SEC Chair). She called for the SEC to take action to begin to “work through how to get investors the standardized, consistent, reliable, and comparable ESG disclosures they need to protect their investments and allocate capital toward a sustainable economy.” (August 26, 2020) She further suggested that failure to address these disclosures presented an opportunity to address ESG risks “in a comprehensive fashion with new rulemaking specific to these topics,” (November 19, 2020) adding that the SEC should create an internal task force and ESG Advisory Committee dedicated to building on recommendations of “leading organizations” such as the TCFD (Task Force on Climate-Related Financial Disclosures).

Given the new Administration’s focus on climate risk and diversity, a new SEC Chair may move forward with more ESG-specific guidance and rulemakings.

— FRB.

- Established a Supervision Climate Committee (SCC) as part of the Division of Supervision and Regulation to further build the Federal Reserve’s capacity to understand the potential implications of climate change for financial institutions, infrastructure, and markets. The SCC will be headed by Kevin Stiroh, formerly the Head of Supervision at the Federal Reserve Bank of New York and currently co-chair of the BCBS TCFR (Task Force on Climate-Related Financial Risks).
- For the first time, called out climate change as a financial stability risk in both its November 2020 Financial Stability Report and Supervision and Regulation Report, noting the agency will monitor and assess the financial system for vulnerabilities related to climate change through its financial stability framework, including through international relationships with the BCBS and FSB. The agency states it is working to better understand, measure, and mitigate climate-related financial risks (inclusive of transmission channels, methodologies, and data gaps), the agency expects supervised banks to have systems in place that appropriately identify, measure, control, and monitor all of their material risks, including climate risks. Notably, the FRB suggests that current misunderstandings about climate change risks can result in “abrupt” repricing events, which can be exacerbated by shifts in public perception or expectations.
- Formally joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) “to share research and identify best practices.” FRB staff are participating in the “Bridging the Data Gaps” workstream that will create a list of gaps in data items needed to model climate risk at the macroeconomic, market, and financial market participant levels.
- Added consideration of climate resilience as a qualifying activity in certain targeted geographies as part of its Community Reinvestment Act ANPR. Further, the NY FRB separately hosted a public event exploring the intersection of approaches in the financial sector to address climate change and opportunities to promote community resilience, especially in low-income communities most vulnerable to the flooding, fires, and more frequent and severe storms caused by climate change. This is generally referred to as “climate justice”.

— FHFA. Released a request for information to strengthen its ability to identify and assess the current and future climate and natural disaster risk of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

— NY DFS. At the state level, NY DFS announced that it expected all of its supervised entities to begin to integrate the financial risks from climate change into their governance frameworks, risk management processes, and business strategies as well as to develop an approach to climate-related financial risk disclosure. The agency indicated it is similarly developing a strategy for integrating climate-related risks into its supervisory mandate.

Industry updates
Industry actions, long the driving force for ESG considerations in the U.S., continue to make headlines. Recent actions include announcements to:
- Change recruiting practices to increase diversity at all employment levels.
- Vote against corporate boards that do not disclose their racial and ethnic composition.
- Link executive compensation to sustainability goals.
— Expect companies to disclose how their long-term business strategies are compatible with a net-zero economy.
— Sell off investments in companies that pose significant climate risk due to “insufficient preparation to the net-zero transition” or “lack of engagement.”
— Pledge funds to promote sustainable investment projects and racial equity initiatives.

What’s next?
Given the heightened attention the Administration, investors, boards, employees, customers, and increasingly U.S. regulators are placing on ESG issues, financial services companies need to take steps to:

— Define the organization’s approach/responsibilities to Climate Risk and ESG, including customer and third-party relationships, across strategies, policies, practices, and mandates; consider establishing targets and timelines to incorporate Climate Risk and ESG decisioning and reporting.
— Develop a roadmap and strategy to assess and begin measuring Climate and ESG-related impacts across any or all key risk areas (e.g., operational, reputational, credit, compliance, liquidity, strategic, model, market, and due diligence).
— Begin to explore exposure from physical and transition risks across asset classes and define how those exposures might impact strategic planning for Climate and ESG risk management.
— Identify and start procuring needed data sets to forecast physical risk; incorporate into bank systems, scenario analysis, economic modeling, and stress testing.
— Align internal definitions with evolving regulatory taxonomies to include Climate Risk and ESG-related impacts (e.g., what “ESG” encompasses, what is “green”, what is “sustainable”).
— As global standards evolve, focus on the integrity of Climate Risk and ESG-related financial data and controls (just like SOX).
— Establish policies and controls in the business and risk management processes to mitigate Climate and ESG-related reputational risks in a timely manner and through proactive monitoring and identification.
— Operationalize a disclosure and reporting framework, locally and globally, for consistency with the firm’s ESG mandate/policy aligned with SEC regulations, TCFD standards, SASB standards and others, as appropriate.

Climate and ESG risks are highlighted in KPMG Regulatory Insights’ Ten Key Regulatory Challenges for 2021, which is available here.

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