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Regulatory Alert

Regulatory Insights for Financial Services

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Climate-Related Risk: CFTC Request for Information

KPMG Insights*. The CFTC joins the other financial services regulators in seeking input on the quickly evolving regulatory landscape for measuring, monitoring, analyzing, and reporting climate-related risks. CFTC expects that market participants from across all sectors, including agricultural, industrial, and financial sectors, will increasingly turn to the derivatives markets to manage/hedge the impact of physical and transition risks and indicates that the RFI will serve to inform, educate, and engage the agency and market participants on climate-related policymaking. Although the RFI was unanimously approved, it is notable that some Commissioners did raise concerns regarding the broad scope of information requested and the limits of CFTC's statutory authorities. Nonetheless, CFTC registrants should be formalizing climate risk governance and risk management and actively evaluating potential risks and opportunities (aligning with TCFD, as appropriate) and the use of scenario analysis.*

In the context of its regulatory and market oversight authorities, the Commodity Futures Trading Commission (CFTC) issued a Request for Information (RFI) seeking comment (by August 8, 2022) on how climate-related financial risk may affect, directly or indirectly, the derivatives and underlying commodities markets as well as any of its registered entities, registrants, or other market participants (see definitions below). CFTC states that it intends to use this information to consider how:

- Market participants may need to adapt their dealing, trading, and advisory businesses in the derivatives markets
- Market participants use the derivative markets to hedge and speculate on various aspects of physical and transition risk
- Registrants and registered entities may need to adapt their risk management frameworks—including margin models, scenario analysis, stress-testing, collateral haircuts, portfolio management strategies, counterparty and third-party service provider risk assessments – and also their enterprise risk management programs
- CFTC may need to adapt its oversight of the derivatives markets, including any new or amended derivative products created to hedge climate-related financial risk.

The RFI includes thirty-four multi-part questions across ten separate categories. Consistent with other financial services regulators (SEC, FRB, OCC, FDIC), the CFTC has directed inquiries on a broad range of issues toward:

- ***Data***
- ***Regulatory reporting***
- ***Disclosure***
- ***Scenario analysis***
- ***Risk management***
- ***Vulnerable households and communities.***

The CFTC is also notably seeking input on:

- ***Voluntary carbon markets***, including whether the CFTC should consider creating some form of

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registration framework for any market participants within the voluntary carbon markets to "enhance the integrity" of those markets

- ***Digital assets***, such as whether digital assets and/or distributed ledger technology offer climate-related financial risk mitigating benefits
- ***Public/private partnerships***, including the potential formation of a standard-setting committee similar to the Alternative Reference Rate Committee (ARRC) that was formed during the LIBOR transition, that might help to develop certain climate-related indices, standards, or best practices
- ***Steps CFTC should take*** "in order to expand its capacity to define, identify, measure, monitor, assess, and report on climate-related financial risks and their effects on financial stability," including consideration of staffing, training, and expertise as well as data analytics and modelling methodologies.

Purpose. CFTC notes that information gained through the RFI will inform the agency's "next steps," including potential actions such as guidance, policy statements, or regulations, as well as its response to the FSOC recommendation that its member agencies "expand their respective capacities to define, identify, measure, monitor, assess, and report on climate-related financial risks and their effects on financial stability." (See KPMG Regulatory Alert here.)

Defined terms.

- "Registered entities" includes designated contract markets (DCM); derivatives clearing organizations (DCO); swap execution facilities (SEF); and swap data repositories (SDR).
- "Registrants" includes commodity pool operators (CPO); commodity trading advisors (CTA); futures commission merchants (FCM); introducing brokers (IB); leverage transaction merchants; floor brokers; floor traders; major swap participants (MSP); retail foreign exchange dealers; or swap dealers (SD) that are subject to the CFTC's regulations; or an associated person of any of the foregoing other than an associated person of a SD or MSP.

Voluntary Carbon Markets Convening. On June 2, 2022, the CFTC hosted the Voluntary Carbon Markets Convening, the purpose of which was "to discuss issues related to the supply and demand for high quality carbon offsets, including product standardization and the data necessary to support the integrity of carbon offsets' greenhouse gas emissions avoidance and reduction claims." Other issues were related to "the market structure for trading carbon offsets and carbon derivatives as well as perspectives on the challenges and opportunities in these markets." CFTC stated the participants included representatives from carbon offset standard setting bodies, a carbon registry, private sector integrity initiatives, spot platforms, designated contract markets, intermediaries, end-users, and public interest groups.

CFTC Chairman Benham suggested the event was "a testament to the strength of public-private partnerships aimed at determining how the derivatives markets can facilitate the transition to a net-zero economy."

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