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May 14, 2020

Commissioner Rostin Behnam
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Comments for the Climate-Related Market Risk Subcommittee Under the Market Risk Advisory Committee

Dear Commissioner Behnam,

We applaud your leadership in considering the steps the Commission can take to address the significant challenges climate change poses to market stability.

As a member of the Market Risk Advisory Committee, Public Citizen submits these comments for the Committee's Climate-Related Market Risk Subcommittee.

Confronting climate change requires aggressive mitigation and adaptation responses. The leveraged nature of commodity derivative trading, and vulnerability of risk from counterparties, acutely expose such markets to significant systemic risk exposure, necessitating Commission action.

To assuage climate risk in CFTC-jurisdictional markets, Public Citizen provides the following seven recommendations:

I. Adjust Capital and Margin Requirements to Properly Reflect Climate Risk

In response to the last financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act assigned the Commission responsibilities to, among many other things, establish both capital and margin requirements on market participants.

Climate change represents a material market risk that should be incorporated along with operational, market, credit, counterparty and other existing risk variables that prudential regulators presently evaluate. Market participants with exposure to fossil fuel asset classes risk losses due to the transition to renewable energy—and these risks become imbedded in commodity derivative markets. The Commission can use its existing Dodd-Frank authorities to strengthen these requirements to incorporate

climate risks, which are not reflected in current standards.[1] And last month, the Basel Committee on Banking Supervision released *Climate-related financial risks: a survey on current initiatives* which concludes that the current regulatory "framework offers flexibility to address climate-related financial risks."[2]

Capital requirements are currently designed to ensure that major market participants are not too highly leveraged, using a ratio of a firm's capital to its risk-weighted assets. Climate change dramatically increases the risk exposure of many assets, and these risks are currently not reflected in today's asset weights.

At a minimum, the Commission should incorporate climate risk into asset weights. At the same time, it also likely should require higher capital ratios and enforce portfolio limits on market participants to reduce exposure to climate risk. Climate risks can be difficult to discern and account for quantitatively. This is true of many particular risks, and even more true when attempting to aggregate or compound multiple risks into a whole. Most risk studies consider only one segment of risk—for example, from increased drought or heat, but not necessarily both. And plenty of climate risks have been under-examined. For these reasons, merely adjusting asset weights based on quantitative estimates of climate risk will inevitably fall short of capturing the full range of risk to a firm's assets. For this reason, the Commission should require higher capital ratios relative to firms' risk-weighted assets in addition to improving the weights.

The new weights and capital ratios should be updated frequently. Scientific and economic understandings of climate risk evolve constantly, and most analytic improvements yield bleaker projections. Moreover, risk grows with the mere passage of time while governments continue falling far short of enacting adequate policies for climate mitigation, adaptation, and resilience.

Climate risk-adjusted capital and margin requirements should apply to swaps dealers and major swaps participants, derivative clearing organizations, designated contract markets and central counterparties.

For the same reasons, the Commission should adjust margin requirements to reflect climate risk. The purpose of margin is that if the derivative bets go sour, counterparties and exchanges are protected because margin keeps enough cash on the table, keep the trading platforms solvent in the case of widespread problems.

We have already seen that exchanges set margin higher for products perceived as being riskier—for example, CME group initially set margin for bitcoin futures at 35% of notional value, compared to initial margin for crude oil as low as 7%. And after the recent turmoil in the WTI crude oil contract (that saw a one day price fluctuation of $55 to a first-ever dive into negative pricing) CME raised crude oil futures maintenance margins by 20% for the June 2020 contract. Increasing margin requirements is what

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[1] Graham Steele, *Confronting the 'Climate Lehman Moment': The Case for Macroprudential Climate Regulation*, March 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542840

[2] At page 7, www.bis.org/bcbs/publ/d502.pdf

you do when faced with greater risk. The Commission should therefore mandate margin requirement adjustments to account for climate risk.

Some market participants are already a step or two ahead of regulators. Barclays discloses in its *2019 ESG Report* that it has implemented a "Credit Climate Lens" to "understand, assess and manage how climate change may impact the Group's credit risk exposures."[3] Standard Chartered "established a Climate Risk Management Forum. The Forum consists of senior business, risk and strategy leaders and is tasked with overseeing the development and implementation of the climate risk framework."[4]

II. Create A Climate Risk Division

The Commission should create a dedicated Division of Climate Risk, with a Director reporting to the Chairman. This division will facilitate coordination, planning and preparation for launching climate risk initiatives.

III. Join the Network for Greening the Financial System

This Commission should join the Network for Greening the Financial System, a coalition of financial regulators dedicated to tackling climate change. Doing so would allow the Commission to share best practices on developing climate risk management for commodity derivative markets.

In addition, several major participants in Commission-jurisdictional markets are members of the U.K.-based Climate Financial Risk Forum, a working group established last year to develop best practices in climate-related risk management. The Commission should participate in that Forum as well.

IV. Initiate a Climate Risk Working Group with U.S. Prudential Regulators

Tackling the risks posed to financial and commodity markets by climate change requires a comprehensive approach involving all U.S. prudential regulators. The Commission should initiate a cross-agency Climate Risk Working Group to include the Federal Reserve, the U.S. Department of the Treasury, the U.S. Securities and Exchange Commission, and the Financial Stability Oversight Council.

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[3] At page 56, https://home.barclays/content/dam/home-barclays/documents/citizenship/ESG/Barclays-PLC-ESG-Report-2019.pdf

[4] *Climate Change/Taskforce on Climate-related Financial Disclosures report*, December 2019, at page 6, https://av.sc.com/corp-en/content/docs/Standard-Chartered-Climate-Change-Disclosures-2019.pdf

V. Incorporate Climate Risk Into Supervisory Stress Tests

The Commission regularly conducts supervisory stress tests of clearinghouses and other commodity derivative market jurisdictional entities. These tests should be expanded to include climate risk scenarios.

For example, the Bank of England has scheduled climate stress tests for mid-2021, and in the next few months will provide guidance to assist market participants in meeting supervisory expectations for climate risk.

VI. Encourage Jurisdictional Entities to Disclose Climate Risk

A challenge facing regulators seeking to account for climate risk is the dearth of climate-related disclosure by key market participants. This absence of uniform environmental, social and governance (ESG) reporting obscures climate risk. The Commission should encourage jurisdictional entities to commit to such disclosures.

VII. Expand Subcommittee Membership to Include More Diverse Voices

The Subcommittee should be applauded for its outstanding work and collaboration. At the same time, its membership falls far short of including the range of voices that should inform the Commission's decision making. As the Subcommittee and the Commission continue work to mitigate climate risk in commodity derivative markets, the Subcommittee membership should be expanded to include diverse voices from academia, environmental groups, and other public interest voices.

Respectfully submitted,

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