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Re: Comments in Support of "Managing Climate Risk in the U.S. Financial System," Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission

I am pleased and honored today to support the Climate-Related Market Risk Subcommittee ("Subcommittee") report today. These written comments represent a longer version of suggestions expressed at the Market Risk Advisory Committee on February 23, 2021.

Valuation is at the heart of IHS Markit or "Mark-It," as IHS Markit's Financial Services Division was once known. Value is also at the heart of the "Managing Climate Risk in the U.S. Financial System" report ("Report").[1] Warren Buffett is quoted as saying "[*p]rice* is what you pay; *value* is what you get."[2] I might modify his idea for today's discussion: the current price of human activity giving rise to greenhouse gas emissions does not reflect what humanity and Planet Earth is getting, as thoroughly documented in the Report.

As the Biden-Harris Administration and other policymakers consider how to react to the Report's call to ensure that an "economy-wide price on carbon is in place at a level that reflects the true social cost of those emissions," I would like to point out some policy tools not specifically mentioned in the Report that may help align the price of carbon with its broader value.

As described in further detail below, there are policy options available to, among others, the Commodity Futures Trading Commission ("CFTC"), Securities and Exchange ("SEC"), bank regulators, and the Environmental Protection Agency ("EPA") to harness capital markets to allocate capital toward sustainable investments.

I should emphasize at the outset, this set of recommendations reflects one observer's thoughts, at this point in time, in response to the Report. Efforts by other policymakers, inside and outside the U.S., as well as private parties, can and will also contribute to a more sustainable future. Below I

[1] Managing Climate Risk in the U.S. Financial System, Sept. 9, 2020, https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf.

[2] Here are the 21 most brilliant quotes from Warren Buffett, the world's most famous and successful investor, Feb. 12, 2020, https://markets.businessinsider.com/news/stocks/warren-buffett-21-best-quotes-2019-2-1027944381.

use the term “climate risk” expansively to include, among other risks arising from climate change, physical risks, transition risks, and climate-related financial risk. I’ve also focused on policy options either not covered in the Report or expand on some that are.

1. CFTC

For the CFTC, there is a lot to do to follow up on this Report in terms of action to help placing the U.S. economy on more sustainable footing. Much of this would require the CFTC to engage non-registrants, including companies, registries, and their service providers in the cash carbon credit markets. The CFTC has laudably established an office to engage non-registrants and innovators through LabCFTC. Moreover, CFTC commissioners have recently provided guidance or otherwise endorsed self-regulation for cryptocurrency and other markets.[3] These suggestions flow from this precedent. For example:

- *Engagement with carbon market standard setters.* The CFTC could take a more active role in the formation of a global market for both cash and derivative carbon products. Congress has assigned to the CFTC the authority to pursue fraud and manipulation in both cash and derivatives carbon markets.[4] The global market in voluntary and mandatory carbon credit trading could benefit from the CFTC’s encouragement and guidance to establish infrastructure that reduces these and other threats to market integrity. To provide a specific example, the CFTC could encourage the development of the carbon markets that reflect the recommendations of the Task Force on Scaling Voluntary Carbon Markets (“TFSVCM”) relating to the development of voluntary carbon markets.[5] For example, the CFTC (either by itself or through the International Organisation of Securities Commissions (“IOSCO”)) should consider TFSVCM recommendations that support market integrity, including Recommended Action (v), Infrastructure: trade, post-trade, financing, and data and (vii) Market integrity assurance.

  Even mostly symbolic actions can help encourage the adoption of practices that will encourage the integrity of carbon markets and contribute to enhanced price discovery in the market for carbon credits. The CFTC could, among other things, incorporate TFSVCM recommendations into new Acceptable Practices for Designated Contract Markets and Swap Execution Facilities under applicable Core Principles when these CFTC registrants offer derivatives contracts referencing voluntary carbon markets that operate consistent with TFSVCM recommendations.

- *LabCFTC participation in development of carbon market technology and infrastructure.* LabCFTC could participate as an observer in new carbon market initiatives that aim to reduce the risk of fraud and manipulation or otherwise promote carbon market integrity. LabFTC participation would be particularly impactful as it relates to the development of the development of post-trade infrastructure and standard reference data for carbon credit markets where innovators and their partners would benefit from the CFTC’s expertise as a

[3] Remarks of Chairman Heath P. Tarbert on Self-Regulation at Northwestern University’s Brodsky Family JD-MBA Lecture November 09, 2020, https://www.cftc.gov/PressRoom/SpeechesTestimony/opatarbert5. Keynote Address by Commissioner Brian D. Quintenz before the DC Blockchain Summit, Mar. 7, 2018, https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz8.

[4] Commodity Exchange Act § 6(c), 7 USC § 9.

[5] TSVCM Final Report, Jan. 2021, https://www.iif.com/tsvcm.

market regulator.

2. **SEC**

The SEC will likely play a pivotal role in realigning capital markets toward a sustainable future. I agree with the finding in the Report that "the lack of standards, and differences among [disclosure] standards, remains a barrier to effective climate risk management." Similarly, Acting SEC Chair Allison Herren Lee has spoken repeatedly regarding the important role the SEC could play in standardizing Environmental, Social, and Governance ("ESG") and climate risk disclosures.[6] In so doing, the SEC may want to take into account the following considerations as it develops the first iteration of an ESG and climate risk disclosure regime.

- *Leveraging existing frameworks*. For many reasons, especially practicality and expediency, the SEC should consider leveraging existing frameworks for ESG and climate risk disclosure like the Task Force on Climate-related Financial Disclosures and Greenhouse Gas Protocol standards as a starting point for the development of its own regime.[7] Borrowing from existing frameworks will enable the SEC to enhance climate risk and ESG disclosure transparency quickly and at a lower cost, for itself and those that have to comply, versus a bespoke approach.

- *Improving upon the chosen frameworks*. The SEC should focus its resources to refining or adding to the chosen frameworks, definitions of particularly high-impact disclosures from issuers that would facilitate banks and investors to better assess and manage their exposures to climate risk. For example, the SEC could provide standardization to a term central to the TCFD regime, "carbon-related asset."[8] The definition should also be designed to ensure consistency with issuer disclosures that would be used as inputs into "carbon-related asset" metrics. To provide another example, working together with the Financial Accounting Standards Board ("FASB"), the SEC could clarify carbon emissions accounting, which, among other areas of varying interpretation, could more clearly delineate the breadth of Scope 3 emissions under the Greenhouse Gas Protocol.

- *Prioritization*. Unlike some other jurisdictions, the SEC may want to propose issuer disclosures before it proposes more substantive standards, e.g., with respect to "green" funds and bonds (see discussion below). This would enable the SEC to incorporate more specific standards for such "green" investments, drawing upon its issuer disclosure regime, vs. standards that, by necessity, would have to be more vague and therefore discretionary

[6] "Broadly, we must ensure that we work with fellow regulators to understand and, where appropriate, address systemic risks to our economy posed by climate change. To assess systemic risk, we need complete, accurate, and reliable information about those risks. That starts with public company disclosure and financial firm reporting, and extends into our oversight of various fiduciaries and others. Investors also need this information so they can protect their investments and drive capital toward meeting their goals of a sustainable economy." Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation, Nov. 5, 2020, https://www.sec.gov/news/speech/lee-playing-long-game-110520.

[7] TCFD Recommendations, https://www.tcfdhub.org/recommendations/ and Greenhouse Gas Protocol, https://ghgprotocol.org/.

[8] TCFD's 2017 report regarding "Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures" defined "carbon-related asset" as a bank's "exposures tied to the energy and utilities sectors under the Global Industry Classification Standard, excluding water utilities and independent power and renewable electricity producer industries." "Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures," 2017, https://assets.bbhub.io/company/sites/60/2020/10/FINAL-TCFD-Annex-Amended-121517.pdf.

in the absence of being able to draw on its own disclosure regime.

- *Comity*. For disclosures that are subject to further development away from the SEC, e.g., carbon and climate risk accounting standards by FASB, bank scenario analyses that will likely produce a set of inputs that could come from issuers by the Network for the Greening of the Financial System ("NGFS")[9] or from U.S. banking regulators, etc., the framework the SEC develops should be flexible to accommodate further development of these disclosures elsewhere. The focus in the interim could be on making sure key disclosures to be developed elsewhere are incorporated into the SEC's climate risk or ESG disclosure proposal even before they are finalized. Conversely, other policymakers should give due deference to the SEC's approach to disclosures and standards governing ESG products. The SEC should work collaboratively with other regulators in the spirit of comity to align disclosure regimes over time to reduce complexity and costs while encouraging comparability and reliability of disclosures across jurisdictional boundaries.

- *Credibility of climate risk mitigation plans*. An important category of high value disclosures would be those that would allow banks and investors to assess the credibility of climate risk mitigation efforts, e.g., those that can provide credibility and accountability relating to climate risk mitigation efforts like net zero emissions commitments, use of internal carbon pricing, participation in voluntary emission reduction programs, carbon credit inventory, calculation of a "cost of carbon hedging," controls or audit around the disclosure of greenhouse gas accounting, etc.

- *Metric-based disclosures.* In order to ensure comparability, the SEC should encourage or require the use of metric-based disclosures with narrative disclosures providing supplemental information only as needed, in line with current financial statement submissions. To the extent practicable, responses should be machine-readable. For example, "Does the company have an overall climate risk policy including physical risk, liability risk, transition risk?" Answers could be expressed as a metric disclosure, i.e. "(1) No, (2)Yes, without Key Performance Indicators (KPIs), and (3) Yes with KPIs." This approach would lower barriers to entry for investors and their service providers, as well as academics and other researchers, that would want to analyze and aggregate this information who might otherwise have to rely on natural language processing (increasing the cost of aggregation and analysis) and could frustrate comparability.

- *"Greenwashing."* ESG investments are growing rapidly with over $1 trillion in ESG mutual funds and ETFs alone.[10] This has led to concerns regarding "greenwashing."[11] The SEC could reduce the risk of greenwashing and increase the reliability of ESG investment

[9] Note that NGFS' work is ongoing. "In Phase II the NGFS will continue to work with a consortium of academic partners to refine and expand the scope of the scenarios." NGFS Climate Scenarios for central banks and supervisors, June 2020, https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf.

[10] "Assets under management in funds that abide by environmental, social and governance (ESG) principles have surpassed $1 trillion for the first time on record, according to data compiled by Morningstar." Sustainable investment funds just surpassed $1 trillion for the first time on record, Aug. 2020, https://www.cnbc.com/2020/08/11/coronavirus-esg-and-sustainable-funds-surpass-1-trillion-for-the-first-time.html.

[11] See e.g., ESG funds defy havoc to ratchet huge inflows, Feb. 6, 2021, https://www.ft.com/content/8e9f8204-83bf-4217-bc9e-d89396279c5b ("But greenwashing looms large, with fears that some asset managers are rebadging funds as ESG investments, with little changes to their strategies.").

classifications by, most importantly, updating prospectus requirements for mutual funds and ETFs. The SEC could also update suitability requirements to ensure that investors with stated ESG investment priorities have adequate information to judge investment options that claim to reflect ESG investment objectives, among other things.

- *"Green" investments and collateral*. There are numerous areas where financial regulators should work together at the initiation of the SEC, who is likely to have the tightest implementation timeline. Many are highlighted above. Another I would suggest is the bank (or broker-dealer) capital or derivatives margin treatment of financial products, e.g., "green bonds" or equities that meet ESG and/or climate risk metrics or scores. Bank regulators and the SEC, along with the CFTC, could also consider whether to encourage investments in these products through preferential bank (or broker-dealer or swap dealer) capital and/or margin treatment for "green" investments and collateral that would reflect the enhanced creditworthiness of the underlying issuer, as well as the benefits of enhancing demand for such products.

3. EPA

The EPA also has considerable power to curb U.S. carbon emissions through existing provisions in the Clean Air Act that would facilitate in encouraging price discovery in carbon markets by encouraging demand for offsets. Most specifically, it should consider exercising its power under section 115[12] in order to provide a framework for the states individually and the United States collectively to meet Paris Agreement emissions targets. The establishment of such a framework could see the EPA establish emissions targets, allocate these targets pro rata among the states, and then defer to individual states to determine how best to achieve those targets, e.g., through a carbon tax, technological requirements, investments in carbon-reducing technologies, state or regional carbon emissions credit cap-and-trade programs, incentives to participate in voluntary programs, etc. From the perspective of the Report and the CFTC, EPA action under section 115 will encourage limits on carbon emissions and, as a consequence, price discovery in carbon markets.

It is an honor to submit these comments and to engage in public service as a member of the MRAC, particularly at this important turning point in the priorities that govern capital markets and the economy more generally. I submit these comments in the collaborative and constructive spirit encouraged by the MRAC and its sponsor, the Honorable Acting Chairman Rostin Behnam.

Please do not hesitate to contact me at salman.banaei@ihsmarkit.com or 202.339.2339 if you have any questions.

Sincerely,

/s
B. Salman Banaei

[12] 42 U.S.C. § 7415, available at https://www.law.cornell.edu/uscode/text/42/7415.

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