

FINANCING A U.S. TRANSITION TO A SUSTAINABLE LOW-CARBON ECONOMY

The U.S. Climate Finance Working Group is comprised of financial services trade associations that have come together to exchange ideas, share knowledge and inform the conversation related to climate and sustainability topics relevant to their respective areas of the financial services industry and the broader corporate sector.

The members¹ of the Working Group are noted below and were instrumental in developing the Principles for a U.S. Transition to a Sustainable Low-Carbon Economy.



1. In addition, several other trade associations, including American Property Casualty Insurance Association and individual financial institutions, provided invaluable feedback and served as important knowledge partners. Hamilton Place Strategies (HPS) served as an Advisor.

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I. EXECUTIVE SUMMARY

Climate change is one of the greatest global challenges facing our society, and financial firms as global capital providers play a key role in financing the creation and deployment of solutions that mitigate greenhouse gas (GHG) emissions, promote green energy generation, and strengthen community resilience.

As the new Administration takes shape, the financial services industry seeks to engage with incoming leaders and members of Congress on a bipartisan basis to help establish a shared vision for U.S. climate policy. By so doing, we hope to inform the policymaking process and demonstrate our willingness and capacity to support a pragmatic approach to transitioning to a more sustainable, and inclusive, low-carbon economy.

Climate change presents both risks and opportunities for the financial services industry. We must build reliable, consistent data sets, metrics, methodologies and standards to ensure that climate-related risks are appropriately understood, managed and disclosed. Transitioning to a lower-carbon economy will require the development of alternative fuels and new technologies, calling for trillions of dollars of investment in innovation and resilient infrastructure.

While individual institutions have a significant role to play in the global effort to address climate change, policy must provide a critical foundation. That is why—as leading financial services trade associations—we have developed a set of Principles for a U.S. Transition to a Sustainable Low-Carbon Economy.

These Principles are intended to serve as a useful framework, offering perspectives from the full spectrum of the financial services industry including banks, investment banks, insurers, asset managers, investment funds, pension funds and other financial intermediaries. These are not exhaustive but do represent essential building blocks that should encourage a pragmatic approach to the transition. The Principles are as follows:

- » Set science-based climate policy goals that align with the Paris Agreement
- » Increase and strengthen U.S. international engagement
- » Provide clear long-term policy signals that foster innovation in financial services
- » Price carbon and leverage the power of markets
- » Minimize costs and support jobs in the transition
- » Foster international harmonization of taxonomies, data standards and metrics
- » Promote more robust climate disclosure and international standards
- » Ensure climate-related financial regulation is risk-based
- » Build capacity on climate risk modeling and scenario analysis
- » Strengthen post-disaster recovery, risk mitigation and adaptation

While the challenges and risks of climate change are real, so too are the opportunities it presents. Together, we can spur innovation and mobilize capital so that the benefits are widespread. The shift to low-carbon growth will entail a significant transformation of the U.S. economy; the U.S. should move ahead quickly but deliberately, supporting robust, sustainable economic growth, investment, and job creation to minimize the costs of transition for households and businesses.

II. INTRODUCTION

CLIMATE CHANGE IS A SIGNIFICANT RISK TO OUR ENVIRONMENT, ECONOMY JOBS

The financial services industry has been active on climate priorities for decades, building an analytical foundation for quantifying, reporting and managing climate risks, and financing climate-related opportunities.

As the world works to recover from the COVID-19 pandemic, demand for new financial products and solutions—to mitigate greenhouse gas (GHG) emissions, strengthen climate resilience, unlock innovation and create jobs—is escalating rapidly. More broadly, investment in green, sustainable businesses is key to transitioning to a low-carbon economy. Importantly, helping companies in hard-to-abate sectors like energy and transportation reduce emissions and develop new business models—i.e., “financing the transition” — is a vital part of the equation.

WE NEED BETTER CLIMATE DISCLOSURE & CONVERGENCE TOWARDS AN INTERNATIONAL STANDARD

Good corporate disclosure is critical for effective climate risk mitigation and capital allocation from the financial services industry. Much progress has been made—for example, via the efforts of the Task Force on Climate-related Financial Disclosures (TCFD) and the work of voluntary environmental, social and governance (ESG) disclosure initiatives. However, climate disclosure needs to be improved to ensure that market participants have information that supports informed decision-making. Ultimately, the goal should be to converge on an international standard, recognizing that the financial services industry is still building disclosure capacity at present.

CONTINUED FOCUS ON A WELL-FUNCTIONING U.S. FINANCIAL SYSTEM

In recent weeks, top officials from the White House, the U.S. Treasury, the Federal Reserve, the SEC, the CFTC and other agencies have warned of the risks of climate change for the U.S. economy and financial system. Many U.S. states and cities have long been active in setting environmental standards, including those related to climate change.

Private-sector-led innovation and market-based solutions can accelerate the needed transition to a low-carbon economy, reduce transition risks and support growth. We continue to believe that direct policy measures to cut GHG emissions are the most efficient way to deliver on climate goals. Any policy measures from financial regulatory or supervisory authorities, if deemed necessary, should be focused on identification, mitigation and management of the financial risks arising from climate change. If taken, such measures should be proportionate, risk-based, informed by consultation and grounded in robust data-driven analysis. It is critical to distinguish between requirements intended to mitigate potential risks to the financial system and those seeking to advance broader economic and social goals.

U.S. ENGAGEMENT IN INTERNATIONAL CLIMATE POLICY DISCUSSIONS IS ESSENTIAL

EU and UK policymakers have been active first movers on climate policy over the past several years, with officials from Asia and many emerging market economies an integral part of the discussion to map out an organized response. However, given the global nature of climate risk, the interconnectedness of the financial system and the multi-jurisdictional footprint of many of our member firms, we believe strongly that the U.S. needs to be actively engaged in international climate policy discussions to help coordinate and support the global transition to a sustainable, low-carbon economy.

III. PRINCIPLES FOR A U.S. TRANSITION TO A SUSTAINABLE LOW-CARBON ECONOMY

SET SCIENCE-BASED CLIMATE POLICY GOALS THAT ALIGN WITH THE PARIS AGREEMENT:

Climate goals should reference widely accepted GHG emissions reduction targets and be based on the best available science and climate scenarios. Goals should have a clear timeline and be aligned with the Paris Agreement. Policies and standards should be data-driven, based on available and accessible information and supported by rigorous research and analysis, which will provide certainty to market players across industries.

While the private sector has a vital intermediation role to play in efforts to address climate change, strong policy frameworks at national and global levels must provide a long-term foundation.

INCREASE AND STRENGTHEN U.S. INTERNATIONAL ENGAGEMENT:

The U.S. should engage proactively through international forums that are shaping global climate policy and frameworks to help orient the financial system's response to climate risks, including the G20 and standard-setting bodies; the Federal Reserve's decision to join the Network for Greening the Financial System (NGFS) will support this engagement.

Climate change is a global challenge that requires global cooperation—with flexibility for local solutions.

Active participation in these international discussions will allow the U.S. to advocate for transparency in policymaking, promote solutions that are compatible with highly sophisticated U.S. capital markets, and help shape international systems and standards under development, ensuring these are also consistent with domestic policy objectives.

PROVIDE CLEAR, LONG-TERM POLICY SIGNALS THAT FOSTER INNOVATION IN FINANCIAL SERVICES:

This is particularly true for hard-to-abate sectors such as transportation and heavy industry. U.S. capital markets play a key role in financing lower-carbon solutions and resilient infrastructure—but require clear long-term policy signals that give investors the confidence to deploy capital at scale. Effective long-term policy will also enable development of the new financial and environmental commodity products sought by our customers—including for example ESG bonds, green mortgages, low-carbon investment funds, climate risk insurance and financial hedging tools. Harmonization of definitions and labels, including recognition of market-based standards and principles, would help achieve the necessary scale in climate investment.

Achieving significant GHG emissions reductions will require more deployment of existing low-carbon technologies, as well as the development and commercialization of new solutions.

**PRICE CARBON AND LEVERAGE
THE POWER OF MARKETS:**

Deep and liquid U.S. capital markets are critical to mobilize the cross-border capital flows needed to finance lower-carbon solutions and climate-resilient infrastructure.

To drive capital investment, we support the use of market-based mechanisms, including a price on carbon that supports long-term decision-making. Carbon pricing can also spur development of climate-related financial products, promote more transparent pricing of climate-related financial risks, and can inform and help scale key initiatives like voluntary carbon markets.

**MINIMIZE COSTS AND SUPPORT
JOBS IN THE TRANSITION:**

Transitioning to a low-carbon and ultimately net-zero economy will require policies that aim to reduce GHG emissions while promoting economic growth, green energy generation and job creation. National policymakers should prioritize achieving GHG reductions at the lowest possible cost and utilize valuable cost containment mechanisms such as high-quality carbon offsets.

Building out sustainable and climate-resilient U.S. infrastructure—which can generate millions of new, well-paying jobs—should remain a key policy goal. Job creation strategies should be broad in scope but targeted at low-income communities in areas and sectors most impacted by transition, with a particular focus on high-unemployment populations including people of color. Special consideration should be given to community and regional-based financial services firms. The specific markets they serve could be negatively affected in the short term and risk management expectations should be proportional to the complexity of their operations.

**FOSTER INTERNATIONAL
HARMONIZATION OF TAXONOMIES,
DATA STANDARDS AND METRICS:**

Widely accepted standards for data and climate risk metrics across sectors will support sound risk assessment and effective disclosure. Shared standards are also key to support market-based solutions that will properly account for the costs of climate change.

International harmonization of taxonomies would greatly improve comparability and alignment of product labeling, corporate reporting and transition finance. Common and more standardized terminology helps investors better understand the distinctions among different types of sustainable assets and products, so they can choose the investment strategy that best fits their preferences. Reaching broad agreement on common terms, data standards and metrics will be essential for financial firms, corporates, consumers, regulators and other stakeholders to identify, measure, disclose and monitor climate risks and opportunities. However, alignment of standards should allow for a degree of regional variation, where needed, to accommodate differences in economic structure, policy goals and pace of transition in different jurisdictions.

PROMOTE MORE ROBUST CLIMATE DISCLOSURE AND INTERNATIONAL STANDARDS:

Good disclosures are critical for effective climate risk mitigation and capital allocation from the financial services industry. Information about risk and opportunity allows lenders and investors to effectively price and manage risk and allocate capital to achieve desired financial returns.

Significant progress has been made in recent years with respect to promoting greater disclosure of climate-related risks and opportunities—for example, via the efforts of the TCFD. However, such disclosures should be enhanced to enable financial market participants and other stakeholders to have cost-effective access to information that supports informed decision-making; in this context, data providers and ratings agencies play an important role. International disclosure frameworks should balance the value of consistency with the need for a degree of flexibility to ensure that disclosures are relevant for individual business models, different sectors and varied operating environments. Ultimately, the goal should be convergence on an international standard for climate and broader ESG reporting.

ENSURE CLIMATE-RELATED FINANCIAL REGULATION IS RISK-BASED:

Financial regulation should remain dedicated to ensuring the resilience and stability of the financial sector.

Prudential tools—particularly any measures that could restrict finance to companies most in need of support for transition—are thus not the most appropriate means of achieving alignment with the Paris Agreement or mobilizing capital towards climate policy goals. Should policy actions to support climate and broader ESG goals be deemed necessary, these should be well aligned at the local, state and federal level. Any such measures should be exclusively risk-based, principles-based, predicated on robust data and well grounded, widely accepted methodologies, and integrate an ex-ante cost-benefit analysis as well as flexibility in the initial stages of implementation.

BUILD CAPACITY ON CLIMATE RISK MODELING AND SCENARIO ANALYSIS:

While good progress has been made, climate risk assessment and scenario analysis efforts are still at early stages worldwide.

Several key challenges remain, including the need for reliable and widely-reported data from companies on GHG emissions, climate risks and opportunities, methodologies to translate the output of physical climate risk models into current investment frameworks, and greater international coordination on the approach to scenario analysis, among others. Financial regulators and industry risk professionals should work together to develop climate risk modeling—supported by rigorous analysis—that can be flexible across different jurisdictions but aligned in approach to avoid fragmentation, with a common set of broad climate risk assumptions, scenarios and guidelines such as those being developed by the NGFS.

**STRENGTHEN POST-DISASTER
RECOVERY, RISK MITIGATION
AND ADAPTATION:**

Risk finance instruments that strengthen climate resilience and enable better disaster recovery for customers and local communities are a critical channel through which the insurance sector can help mitigate physical climate risks.

People, businesses, and supply chains around the country—particularly in areas most vulnerable to the impacts of climate change—need access to products that include risk mitigation and resilience as well as protection for their long-term prosperity. Market-led, customer-centric innovative financial solutions from insurers and reinsurers, as well as lenders and investors, should be paired with a policy and regulatory environment that supports associated commercial opportunities. Further development of ESG derivatives will enable better hedging of climate-related risks.