Securities Regulation Daily Wrap Up, SEC NEWS AND SPEECHES—Commissioner Lee offers insights on playing the long game with ever-increasing climate change risks, (Nov. 6, 2020)

Securities Regulation Daily Wrap Up

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By Brad Rosen, J.D.

In remarks before a PLI conference, the SEC commissioner addressed the growing risks arising from climate change, as well as potential steps to be taken and solutions related these risks.

At the onset of her keynote address at PLI's 52nd Annual Institute on Securities Regulation, SEC Commissioner Allison Herren Lee observed that the risks arising from climate change are looming even larger than the grave human and economic costs related to the COVID-19 pandemic as experienced over the past eight months. In remarks titled *Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation*, Commissioner Lee identified numerous ways in which the risks and opportunities arising from climate change converge with the financial markets and SEC's foundational oversight mission with respect to investor protection, facilitating capital formation, and maintaining fair, orderly, and efficient markets.

Setting the climate change table. Observing that science tells us that the need to act is urgent, Lee pointed to a 2018 study by scientists in the U.K. and the Netherlands which estimated that the so-called "point of no return" for achieving the Paris Accord's two degrees Celsius goal by 2100 may arrive as soon as 2035. While noting that the SEC does not set emissions standards, implement carbon pricing, or otherwise shape energy or environmental policy, the agency can and should play a key role with a focus on solutions. Lee stated, "[W]e must ensure that we work with fellow regulators to understand and, where appropriate, address systemic risks to our economy posed by climate change." She added, "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."

Climate change: a systemic risk to financial markets. Lee noted a growing consensus among financial regulators and international authorities that climate change presents a systemic risk to financial markets. Specifically, she noted that climate change risks have the potential to trigger "shock amplifications," which is the notion that a given shock to the financial system may be magnified by certain forces and propagate widely throughout the system. In the climate context, systemic shocks are more likely when assets prices don't fully incorporate the relevant risks.

The commissioner went on to observe there is clear evidence that climate risks are currently underpriced, particularly with respect to long-dated assets, utilities, and commercial mortgage-backed securities, among others. She asserted that underpricing can lead to abrupt and disruptive re-pricing as markets discover the anomalies. This reckoning could be triggered by massive climate-related events, as well as by significant changes in legal requirements that can render assets and even business models obsolete in a very short timeframe.

The need for uniform, consistent, and reliable disclosure. According to Commissioner Lee, all policy should proceed from a foundation and clear-eyed analysis of accurate, reliable data, noting, "Policy makers need it and, importantly, those steering the capital that drives our economy need it." Moreover, the commissioner observed that ESG risks and metrics now often underpin traditional investment analyses designed to maximize risk-adjusted returns on investments of all types and represent a core risk management strategy for portfolio construction.

While noting that that investors, asset managers responsible for trillions in investments, issuers, lenders, credit rating agencies, analysts, index providers, stock exchanges, and other financial market participants have embraced sustainability factors and metrics as significant drivers in decision-making, capital allocation, pricing and value assessments, Lee believes more needs to be done.

In part she urges the SEC to work with market participants toward a disclosure regime specifically tailored to ensure that financial institutions produce standardized, comparable, and reliable disclosure of their exposure to climate risks. In Lee's view, the bottom line is that businesses now actively compete for capital based on ESG performance and that competition needs to be open, fair, and transparent.

Concluding observations. Commissioner Lee also shared some thoughts about the role funds, their advisors, credit agencies, and financial accounting rules play with respect to climate and SEC oversight. In her view, the exigencies presented by climate change are an all-hands on deck effort. She sees the need to solicit engagement from all market participants, leverage the work that has already been done by others, and move forward with considered, informed rule-making and other initiatives in this space.

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