

The New Agenda for Sustainable Investment: Disclosure on Financial, Human and Physical Capital

Climate Change

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Financial Risk Management: Lessons for Addressing Climate Change

- Risk management requires consideration of worst-case scenarios
- A growing risk is an urgent priority; time is of the essence
- The purpose of risk management is not to minimize risk, it is to price risk appropriately
- Risk is what we measure; uncertainty is what we manage



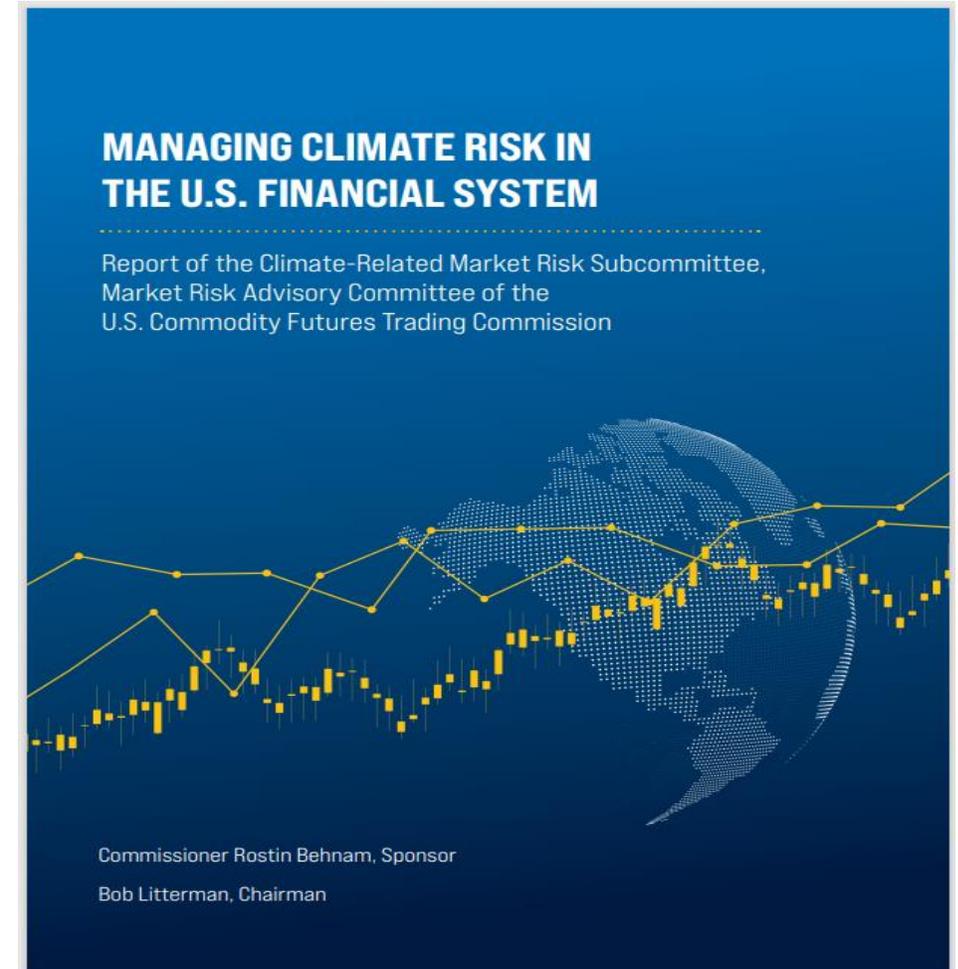
Managing Climate Risk in the U.S. Financial System

The Commodity Futures Trading Commission commissioned an advisory subcommittee to create a roadmap for managing climate-related risk to the U.S. financial system which was published September 9.

The report was unanimously approved by the subcommittee members, which included major banks, insurance companies, data providers, an exchange, oil and agricultural companies, academics, think tanks and environmental organization.

Commissioner Rostin Behnam asked for a 50-page, high-level, consensus report with many specific recommendations.

I think we met every goal, except that it took 165 pages. We agreed on more than expected, including 53 specific recommendations with supporting material.



Members of the Subcommittee



The Subcommittee Was Given a Broad Mandate

Workstreams focused on:

Climate Risks	The Role of Financial Regulators
Data & Analysis	Scenarios & Stress Tests
Climate Risk Disclosure	Financing the Net-Zero Transition

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“What Did We Agree On?”

“Let’s start with the need for appropriate incentives. Appropriate incentives are fundamental to the efficient allocation of capital. They are urgent, they are missing, and they need to be addressed. Financial markets today are not pricing climate risk. The financial markets cannot do that on their own. Until this fundamental flaw is fixed, capital will flow in the wrong direction. That is the context for, but not the focus, of this report.”

Recommendation

Recommendation 1: The United States should establish a price on carbon. It must be fair, economy-wide, and effective in reducing emissions consistent with the Paris Agreement.

This is the single most important step to manage climate risk and drive the appropriate allocation of capital.

Beyond the Need to Price Climate Risk

“This report reflects agreement around a set of fundamental principles”

“The need for collaboration with international efforts to address climate-related financial market risk.

The need for leadership by the financial regulators to guide an iterative process forward while leaving room for American financial innovation.

A consensus about the need to quickly improve the quality of the data, analytics, and understanding of the many dimensions of climate risk.

Approaches to scenario analysis, stress testing, and standardization of definitions that will help move us forward on what will no doubt be a complex, iterative path toward the development of meaningful disclosure of material climate risk information.

A goal toward which we all agree we must move more quickly.”

Central Banks Play a Crucial Role

“All relevant federal financial regulatory agencies should incorporate Climate related risks into their existing monitoring and oversight function”

Regulators should further develop internal capacity on climate related risk measurement and management. Research arms of federal financial regulators should undertake research on the financial implications of climate related risks.

Research should also include the impact of climate risk on financial system assets and liabilities.

Financial supervisors should require bank and nonbank financial firms to address climate related financial risks through their existing risk management frameworks in a way that is appropriately governed by corporate management.

Financial authorities should consider integrating climate risk into their balance sheet management and asset purchases, particularly relating to corporate and municipal debt.

International Coordination is Essential

For example, the report references the Central Banks and Supervisors Network for Greening the Financial System (NGFS) 53 times.

Federal financial regulators should actively engage their international counterparts to exchange information and draw lessons on emerging good practice regarding the monitoring and management of climate related financial risks.

Working closely with financial institutions, regulators should undertake—as well as assist financial institutions to undertake on their own—pilot climate risk stress testing as is being undertaken in other jurisdictions and as recommended by the NGFS.

U.S. regulators should engage in international forums, such as the NGFS, to ensure that climate risk stress testing conducted in the United States is comparable to similar exercises in other jurisdictions and avoid duplicative exercises for institutions with a multi-jurisdictional footprint.

Financing the Net-Zero Transition

“The transition to a resilient, net-zero emissions future is the linchpin in managing long-term climate risk to the U.S. economy and households.”

Fiscal Policy

The U.S. government’s fiscal authority—its capacity to spend, borrow, and structure the tax code—can significantly increase the scale of investment in sustainable projects.

Fiscal policy can support the many co-benefits of the transition, including job creation and the promotion of equity for historically marginalized communities. Additionally, it can drive continued innovation by funding basic scientific research and the deployment of mature technologies.

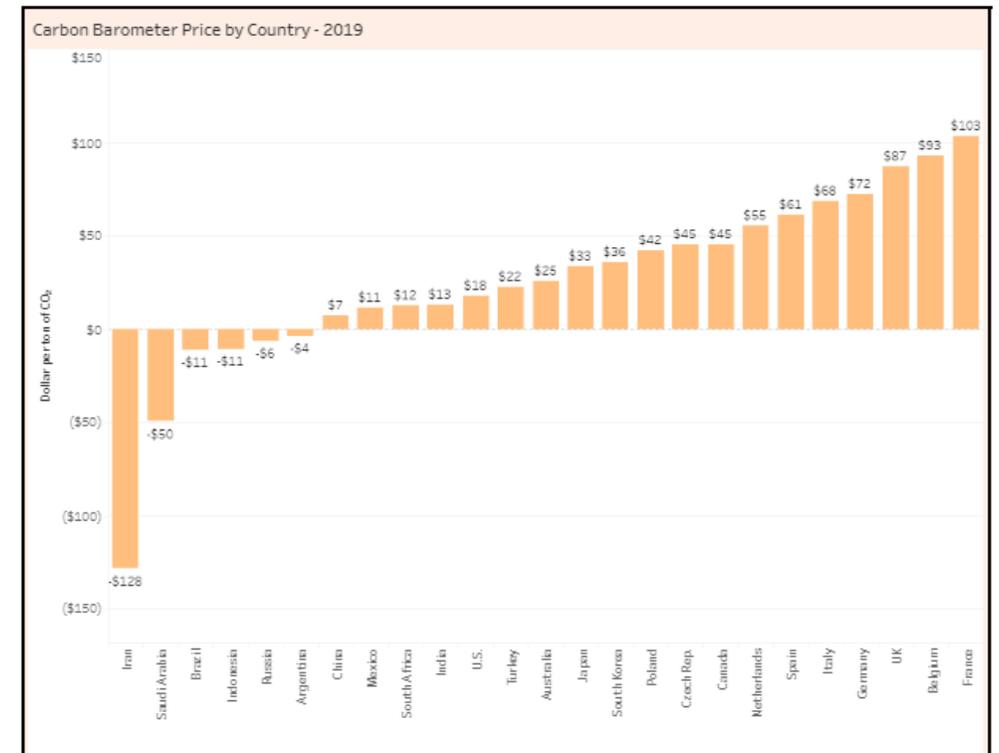
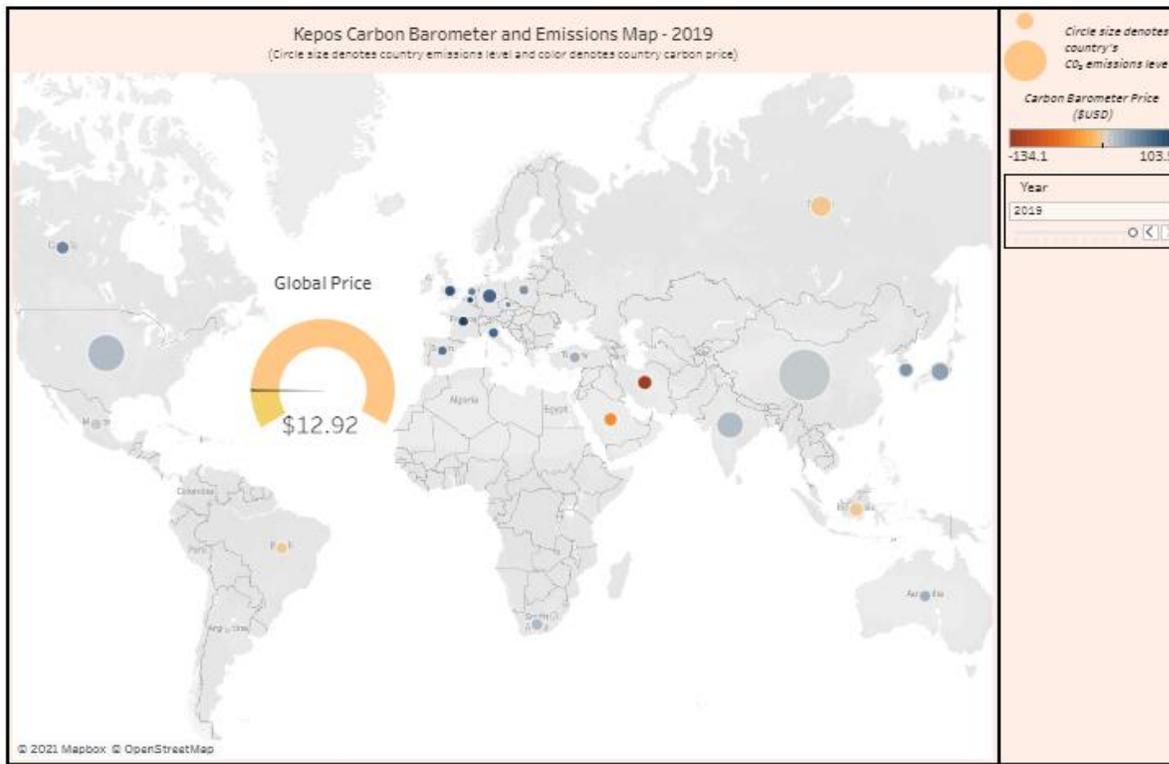
Fiscal policy includes economic stimulus, disaster relief, and infrastructure, all of which have implications for climate risk. Future spending offers possibilities for reducing the structural barriers holding back the transition to a net-zero emissions future, while simultaneously supporting the economy.

Policymakers’ ambition should be to enhance the economy’s long-term potential, including by managing climate risk, not to maintain the status quo.

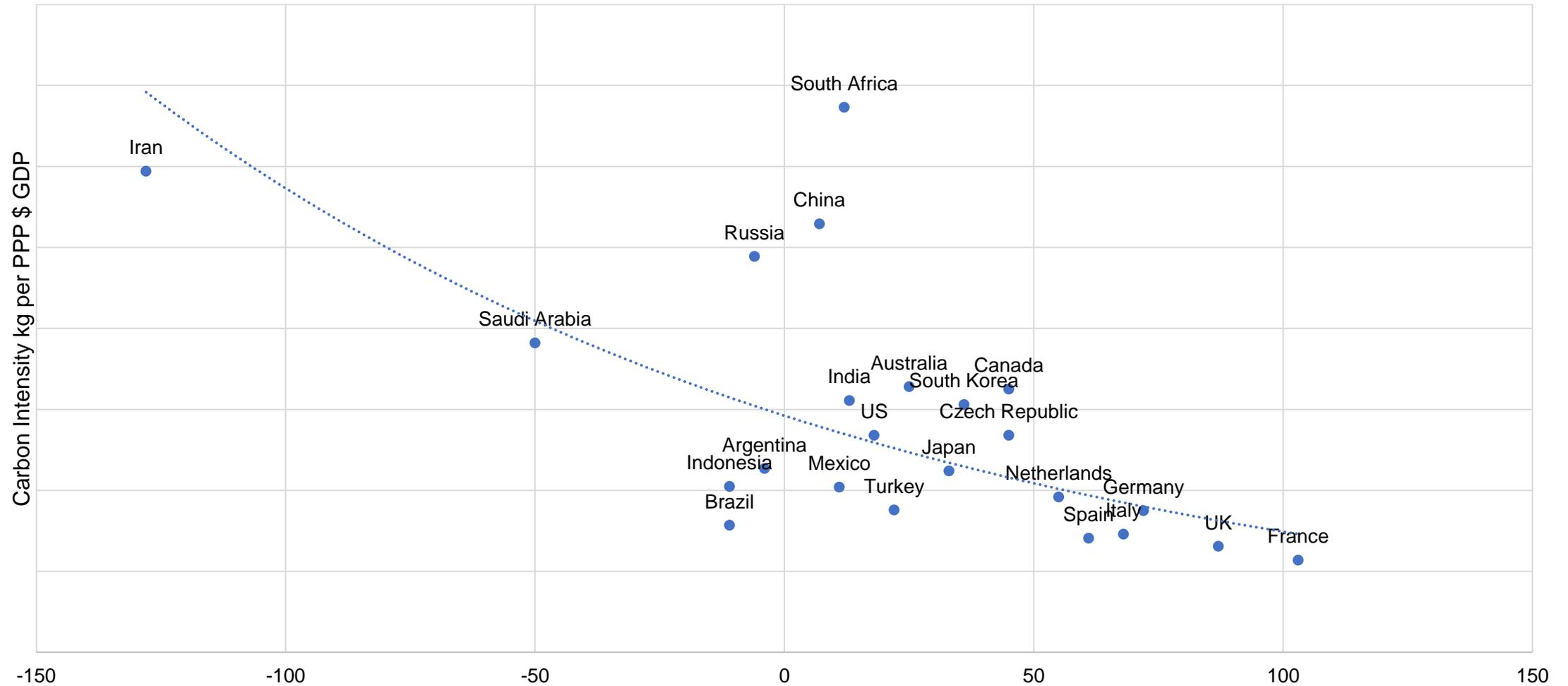
Kepos Carbon Barometer Tracks Global Incentives to Reduce Emissions

We track carbon taxes, cap & trade systems, gasoline and other fossil fuel taxes and subsidies, renewable portfolio standards, feed-in-tariffs, and low-carbon-fuel-standards.

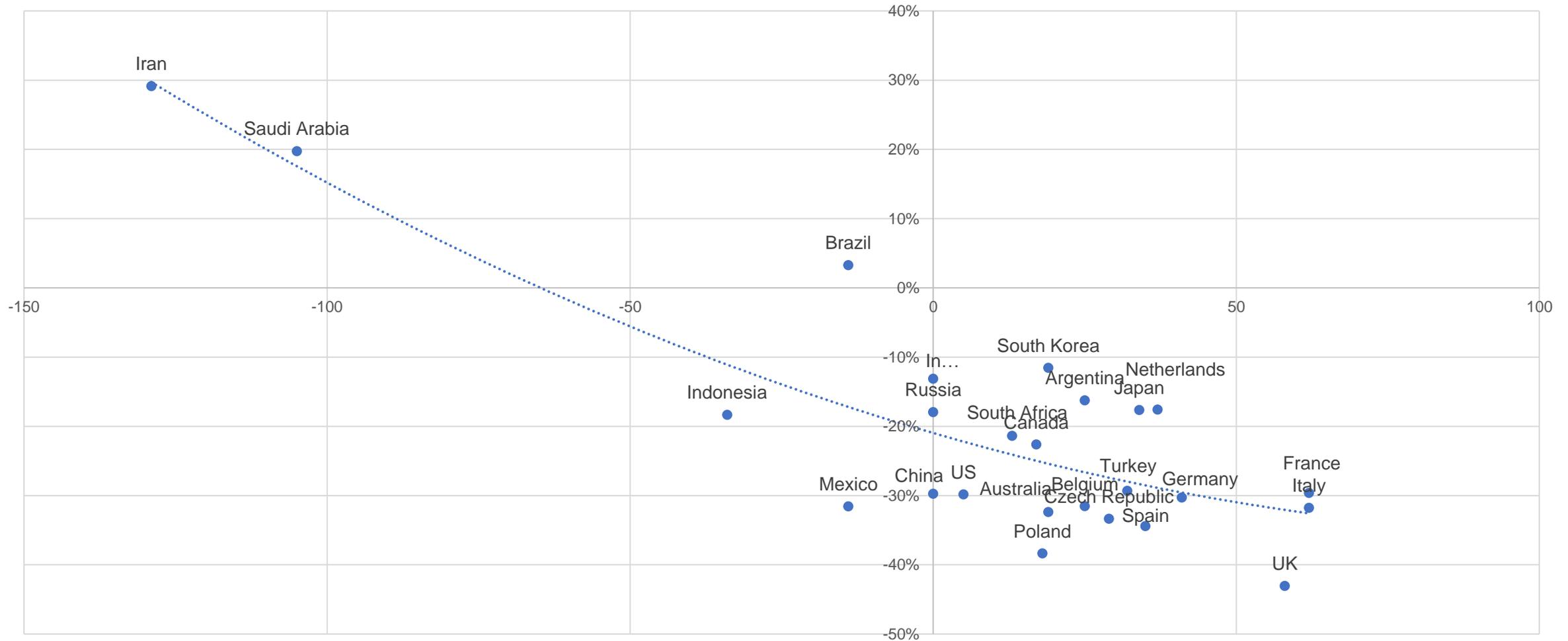
<https://www.carbonbarometer.com>



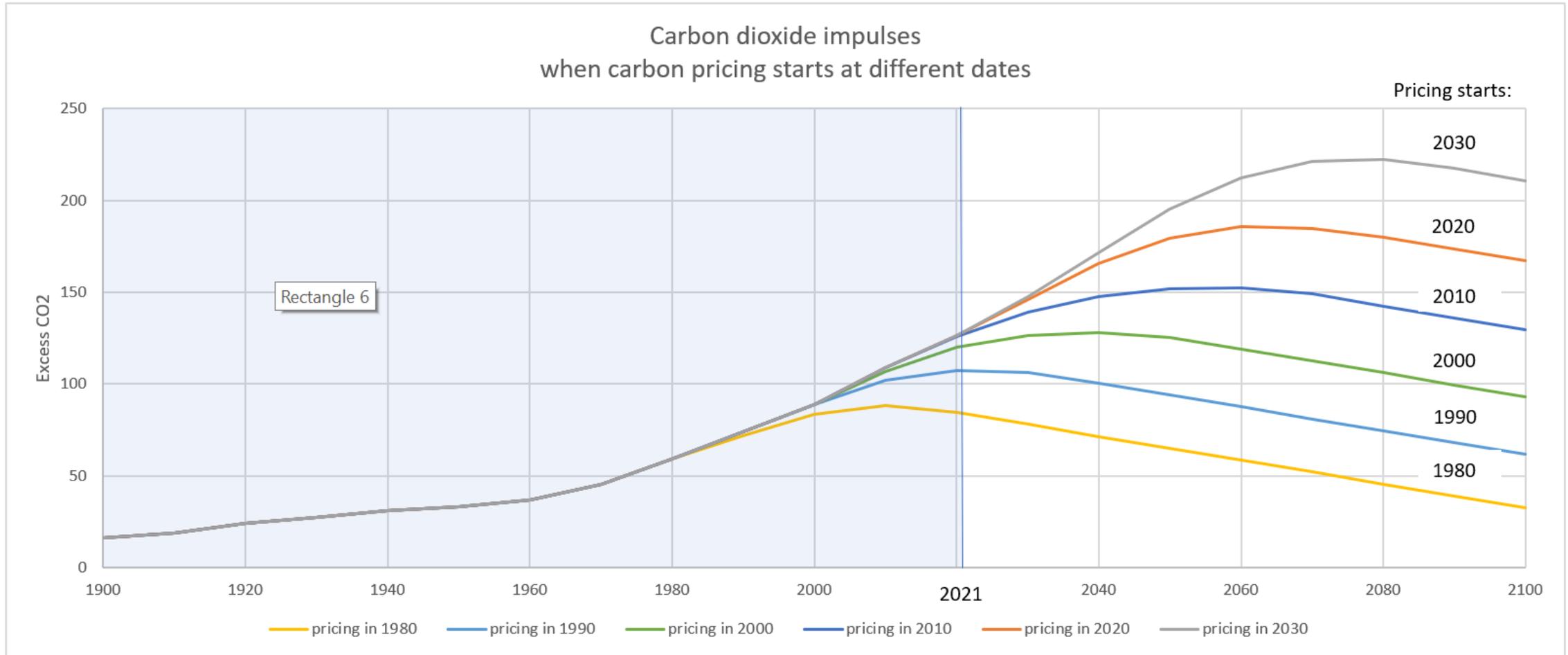
Carbon Intensity as a function of the 2019 Comprehensive Carbon Price



Percent Change in Carbon Intensity, 2008 to 2019 as a function of the 2008 Comprehensive Carbon Price



Time is a Scarce Resource in Managing Climate Risk



Maximum Temperature Depends on When Society Prices Climate Risk

