BACKGROUNDER
No. 3634 | JUNE 24, 2021
INSTITUTE FOR ECONOMIC FREEDOM

Using Financial Regulation to Fight Climate Change: A Losing Battle

Norbert J. Michel, PhD, David R. Burton, and Nicolas D. Loris

KEY TAKEAWAYS

President Biden is using executive orders to address climate change with financial regulations, directing officials to submit reports and solutions by November.

Such regulations will have little impact on climate change, but will raise costs, create barriers to entry, and reduce productivity, among other consequences.

The existing legal framework gives the government enormous discretion. Companies should be allowed to gauge their own risks without new government mandates.

The Biden Administration is actively seeking to "combat" climate change through financial regulation.[1] In a May 20, 2021, executive order, President Joe Biden stated that it is the policy of his Administration

> to advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk, including both physical and transition risks; act to mitigate that risk and its drivers, while accounting for and addressing disparate impacts on disadvantaged communities and communities of color and spurring the creation of well-paying jobs; and achieve our target of a net-zero emissions economy by no later than 2050.[2]

The executive order directs various government officials to deliver reports to the President with recommendations for further action by mid-November 2021. Soon thereafter, a wide range of regulatory actions by agencies throughout government can be expected. White House officials involved include the Assistant to the President for Economic Policy, the Director of the National Economic Council, the National Climate Advisor,[3] and the Director of the Office of Management and Budget.

The Treasury Secretary, after consultations with the multi-agency Financial Stability Oversight Council (FSOC),[4] is to make recommendations. The Secretary of Labor is directed to identify climate-related agency actions that can be taken under the Employee Retirement Income Security Act and the Federal Employees' Retirement System Act.

The Secretary of Agriculture, the Secretary of Housing and Urban Development, and the Secretary of Veterans Affairs are to "consider approaches to better integrate climate-related financial risk into underwriting standards, loan terms and conditions."

The Federal Acquisition Regulatory Council, in consultation with the Chair of the Council on Environmental Quality, is to consider amending the Federal Acquisition Regulation to achieve climate-related objectives.

Exactly what the Administration and the various independent agencies will do remains unclear, but the existing regulatory framework provides more than enough flexibility to implement a wide variety of new climate-related regulations without new legislation and, in many cases, with no new rulemakings.[5]

Some of the Administration's recent moves provide a hint to what might be on the horizon, including new taxes, disclosure requirements, and other capital market regulation.[6] New regulations can be expected to raise costs for both consumers and businesses, create barriers to entry that help large incumbent firms by reducing competition, reduce the productivity and competitiveness of U.S. employers, harm wages, and have other adverse social consequences. Such regulations are poorly conceived, as they will have virtually no impact on climate. They are primarily about virtue signaling, creating political pressure on companies to further progressive political and social goals, and the ability to grant regulatory favor to politically connected businesses.

In the securities regulation area, the most likely avenues to progressive ends are to exploit the Security and Exchange Commission's (SEC's) disclosure regime designed to protect investors by, among other things, redefining what is "material" and what must be disclosed, to further federalize corporate governance and to pressure or assert political control over the disturbingly small group of proxy advisory firms and investment advisers[7] that exercise effective control over most public companies.

The Administration can also be expected to use banking regulations to allocate credit by favoring firms that further its political goals and to disfavor firms in industries that disturb progressive sensibilities (such as fossil fuels, firearms, and non-organic agriculture). Limits on access to banking services and payment systems for disfavored firms or those holding disfavored points of view may also be forthcoming. There will be a major effort by the federal government to capitalize a "National Climate Bank" or a "Clean Energy and Sustainability Accelerator" to provide many tens of billions of dollars of additional federal funds to green energy firms, and potentially incur contingent liabilities of hundreds of billions of dollars.[8]

The acting U.S. Securities and Exchange Commission (SEC) Chair recently requested public input on climate-change disclosures for public companies, and the newly confirmed Chair, Gary Gensler, supports new climate-risk disclosure requirements of some sort.[9] Treasury Secretary Janet Yellen recently named John Morton to lead a climate hub within Treasury, a group that will coordinate "wide-ranging efforts to fight climate change through economic and tax policies," and even "focus on financing for investments needed to reduce carbon emissions."[10] Secretary Yellen also recently outlined her department's international priorities, including "working closely with our international partners and international organizations to implement ambitious emissions reduction measures…and promote the flow of capital toward climate-aligned investments and away from carbon-intensive investments."[11]

The regulatory framework would give federal regulators multiple avenues through which to impose such regulations even if the Dodd–Frank Act were repealed in its entirety. This *Backgrounder* provides an overview of proposals to revamp SEC disclosure requirements. It also summarizes the clearest pathways that federal financial regulators could use to impose new climate-change-related regulations on companies. This *Backgrounder*'s authors argue that, given the enormous uncertainties surrounding climate-change predictions and the tenuous connection between financial disclosure and, for example, emissions, regulations based on such estimates are unlikely to affect the climate, and will have an adverse impact on the economy.

It is likely, however, that such federal regulations will result in an army of well-paid consultants, lawyers, and accountants who will provide compliance advice to public companies subject to these rules, or to corporations seeking capital from the government on favorable terms, and that those living off this compliance and credit eco-system will become effective lobbyists for maintenance of the system. Furthermore, federal financial regulators simply do not have the scientific expertise to police the accuracy of various climate models and of corporate prognostications on how climate change will affect operations a decade or more hence. A much better approach would be to allow companies to gauge their own risks without new government mandates, and to determine which of their risks are material to investors. Indeed, energy efficiency has been improving for the past three decades because of private efforts, not government mandates.[12] Finally, government should not be in the business of allocating credit to politically favored interests, and regulatory agencies should not have the enormous level of discretion that they currently do to impose regulations on financial institutions.

Climate Model Uncertainty

Objective, transparent science can help to guide public policymaking and investments made by the private sector. However, the centralization and standardization of how the private sector assesses risk typically does far more harm than good. With respect to climate risk, failing to acknowledge the uncertainties and limitations of climate models, and climate risk-assessment models, will only exacerbate the harm inflicted by federal regulations.

For instance, in a February 2021 article in *Nature Climate Change*, climate scientists warn of the longer time horizons that climate models use compared to shorter-term data that may be of better use to the financial sector.[13] While businesses tend to need projections for the next few months or years, most climate models make projections over multiple decades. As one author noted, "In the same way that a Formula One Grand Prix car is not what you would use to pop to the supermarket, climate models were never developed to provide finessed information for financial risk."[14]

Other climate experts have also criticized the veracity of climate analytics,[15] and overreliance on these models and data could seriously misrepresent any climate-related risks. As Tanya Fiedler, lead author of the *Nature Climate Change* study, remarked, "Businesses like using models, because the numbers give them a sense of security. It doesn't necessarily mean the numbers are reliable."[16] The federal government forcing companies to disclose risks and make investments based on unreliable data would only add to uncertainty in markets and waste economic resources. Furthermore, federal financial regulators lack even the most basic environmental science expertise and are wholly unprepared to determine which climate disclosures and which climate models are accurate and which are not.

A full evaluation of the scientific evidence reveals substantial uncertainty about the future of climate change and its estimated impacts and costs.[17] For instance, there is considerable debate in the climate community over how a doubling of carbon-dioxide emissions would affect global surface temperatures (equilibrium climate sensitivity). The Intergovernmental Panel on Climate Change range of 1.5 degrees Celsius to 4.5 degrees Celsius has stayed the same since the organization's first report in 1990. Despite attempts to narrow the range using climate models and historical climate data, there is still a great deal of uncertainty.

Another point of debate is the use (and misuse) of different future greenhouse-gas concentration trajectories (known as representative concentration pathways). The worst-case concentration pathway, for example, assumes unlikely projections of coal use,[18] high population growth, low economic growth, and little technological progress. Using the worst-case scenario of these emissions concentration pathways as the business-as-usual scenario will mislead the private sector, policymakers, and regulators on the estimated climate impacts and costs.[19]

Some of this uncertainty is revealed in the fact that actual climate change has not always matched up with what models predicted, though climatologists have tried to explain away the differences.[20]

Furthermore, the integrated assessment models used to justify the "social cost" of carbon dioxide and other greenhouse gas emissions are not credible for policymaking. The output from these models changes significantly with reasonable changes to the inputs. In particular, reasonable adjustments to inputs for climate sensitivity and discount rates dramatically lower the estimated social cost of carbon. Finally, attempts to forecast economic damages centuries into the future, as the integrated assessment models do, significantly strains credibility when moving to the real world of risk assessment and policy implementation.[21]

Federally mandating risk disclosures based on these models will induce a greater amount of uncertainty into financial markets. It will substantially increase issuer expenses and expose public companies to new liability exposure from private litigation and heighten regulatory risk. It will likely be one more significant factor in the continued decline in the number of public companies. Neither the SEC nor banking regulators have the technical expertise to evaluate climate science and the relative efficacy of climate models. The SEC is certainly incapable of policing the accuracy of issuers' prognostications on the potential impact of climate change on their financial prospects a decade, or even many decades, from now.

SEC Disclosure Rules

The SEC states that "[t]he mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[22] The core purpose of securities law is to deter and punish fraud.[23] Fraud is the misrepresentation of material facts or the misleading omission of material facts for the purpose of inducing another to act, or to refrain from action, in reliance upon the misrepresentation or omission.[24] Federal law prohibits fraudulent securities transactions.[25] So do state blue sky laws.[26]

The second important purpose of securities laws is to foster disclosure by firms that sell securities to investors of material facts about the company needed to make informed investment decisions.[27] Appropriate mandatory disclosure requirements can promote capital formation, the efficient allocation of capital, and the maintenance of a robust, public, and liquid secondary market for securities.[28] The reasons for this include (1) that the issuer is in the best position to accurately and cost-effectively produce information about itself;[29] (2) that information disclosure promotes better allocation of scarce capital resources or has other positive externalities;[30] (3) that the cost of capital may decline because investors will demand a lower risk premium;[31] (4) that disclosure makes it easier for shareholders to monitor management;[32] and (5) that disclosure makes fraud enforcement easier because evidentiary hurdles are more easily overcome.[33]

Regulatory changes requiring amorphous disclosure about climate-change risks based on highly contentious models and assumptions, often about the distant future, do nothing to further these objectives. To the extent that climate-change risk disclosure is *actually* material, it currently must be disclosed under current securities law principles.

The baseline for measuring the benefits of mandatory disclosure is not zero disclosure. Firms would disclose considerable information even in the absence of legally mandated disclosure. It is, generally, in their interest to do so.[34] Before the New Deal securities laws mandating disclosure were enacted, firms made substantial disclosures, and stock exchanges required disclosure by listed firms.[35] Firms conducting private placements today make substantial disclosures notwithstanding the general absence of a legal mandate to do so.[36] The reason is fairly straightforward: In the absence of meaningful disclosure about the business, and a commitment, contractual or otherwise, to provide continuing disclosure, few would invest in the business and those that did so would demand substantial compensation for the risk they were undertaking by investing in a business with inadequate disclosure.[37] Voluntary disclosure allows firms to reduce their cost of capital and, therefore, they disclose information even in the absence of a legal mandate.

Regulation S-K[38] is the key regulation governing non-financial statement disclosures of registered (that is, public) companies. Regulation S-X[39] generally governs public company financial statements in registration statements or periodic reports. These two rules, including the various rules and accounting policies that they incorporate by reference, impose the vast majority of the costs incurred by public companies.

Excessive disclosure mandates, however, have two adverse effects. First, the costs imposed impede capital formation and have a disproportionate negative impact on small and start-up companies. This, in turn, harms economic growth and job creation. Largely because of current disclosure burdens, the number of public companies has declined sharply over the past two decades and companies remain private longer.[40] This means that most of the gains from successful start-up companies accrue to already affluent accredited investors rather than the broader public.[41] Second, once disclosure documents reach a certain length, they obfuscate rather than inform.[42]

The concept of materiality has been described as "the cornerstone" of the disclosure system established by the federal securities laws.[43] The Supreme Court has held that information or facts (or omitted information or facts) are material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.[44] The Court has also indicated that information is material if there is a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of available information.[45]

There is no definition of "material" or "materiality" in the Securities Act or in the Securities Exchange Act, although the term "material" is used in both many times. The SEC has defined the term "material" in its regulations and changed its definition over the years, often to conform to Supreme Court holdings. The current definition found in 17 CFR § 240.12b-2 is:

> Material. The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.

The Supreme Court and regulatory definitions are fine as far as they go but they are quite general and provide little practical guidance to issuers. There is a spirited debate about whether "principles-based" or more "prescriptive," bright-line rules should govern disclosure by issuers of material information.

There is a major effort to redefine what is material, to include information that is directed at achieving various social or political objectives.[46] The effort to redefine materiality usually takes the form of saying that investors are "demanding" information relating to environmental or social matters. A closer look, however, shows that ordinary investors are demanding no such thing. It is usually politically motivated actors, such as government-run pension funds or a few increasingly "woke" proxy advisory firms or investment advisers, that support such disclosures.

The effective duopoly[47] in the proxy advisory business, largely a regulatory creation, means that two advisory firms can change the votes of potentially as many as 38 percent of corporate shares of public companies in the United States.[48] This raises serious concerns, particularly when paired with the high degree of concentration in the fund advisory business. For example, the top 10 mutual fund advisers control approximately two-thirds of all net assets under management.[49] Mutual funds, in turn, account for about 82 percent of assets managed by registered investment companies.[50] The top 15 mutual fund advisers have assets under management (all types, foreign and U.S.) roughly equal to the total U.S. stock market capitalization.[51] Some of these assets under management are invested abroad. It is not clear how much. Overall, institutional investors control about 71 percent of the shares held in the United States.[52] This concentration means that an extremely small group, perhaps as few as 15 to 20 proxy advisory firms and investment fund managers can exercise effective control over most public corporations in the United States. Fund management firms are generally compensated from sales commissions (often called loads) and investment management fees are typically based on assets under management. Their compensation is not closely tied to performance.

Thus, these firms will often see an advantage in selling "socially responsible" products that perform no better, and often worse, than conventional investments. They can both court political favor from progressive politicians and organizations and enhance profitability from moving customers to different funds. Congress and the regulatory agencies[53] need to make it clear that investment advisers managing investment funds, or those managing retirement funds or accounts, have a duty to manage those funds and vote the shares held by the funds in the financial, economic, or pecuniary interest of millions[54] of small investors and not in furtherance of managers' preferred political objectives.[55]

Investors are free to invest in benefit corporations that explicitly have a dual purpose (social or philanthropic, and profit). Few do so. They may invest in funds that have a social as well as an investment purpose. A small proportion do so. When afforded the opportunity to vote on shareholder resolutions that would instruct management to pursue social goals, very few do so.[56]

The focus of the materiality standard should remain on what investors need to know to meet their financial, economic, or pecuniary objectives, not a regulator's preferred political or social objectives. Congress should statutorily define materiality in terms generally consonant with Supreme Court holdings on the issue, and should specifically exclude social and political objectives unrelated to investors' financial, economic, or pecuniary objectives.[57]

Traditionally, the purpose of a business has been to earn a return for its owners by cost-effectively combining the capital and entrepreneurial spirit of its founders and owners with the labor and talent of its employees in a competitive environment to satisfy the wants and needs of its customers. The relationships among owners, management, workers, suppliers, and customers are (subject to certain broad constraints imposed by law) privately decided and voluntary.

The effort to redefine materiality in the securities laws is part of an increasingly strident effort to redefine the purpose of businesses more generally in order to achieve social or political objectives unrelated to earning a return, satisfying customers, or treating workers or suppliers fairly. This is being done under the banner of social justice; corporate social responsibility (CSR); stakeholder theory; environmental, social, and governance (ESG) criteria; socially responsible investing (SRI); sustainability; diversity; business ethics; common-good capitalism; or corporate actual responsibility.[58]

If successful, these attempts to redefine the purpose of business would have marked adverse social consequences. To wit:

- Management would be even less accountable to anyone since the metrics of success will become highly amorphous and change constantly.

- Businesses would become less productive and less competitive. Jobs would be lost, and wages would grow more slowly.

- The return to investors can be expected to decline.

- By creating large inefficiencies in the economy and allocating resources politically, the social welfare cost of going down this road would be considerable.[59]

Federal Banking Regulatory Framework

Financial firms' activities are highly regulated, more than those of most nonfinancial businesses. Bank activities are highly regulated by both state and federal regulators, more so than those of most types of nonbank financial firms. Although this dual state–federal system has existed for more than a century, the bank regulatory framework is now more federalized than ever because the 1991 Federal Deposit Insurance Corporation Improvement Act (FDICIA) requires that any FDIC-insured state bank not engage in any activity impermissible for national banks—and nearly all state banks are FDIC-insured.[60] Many federal agencies can influence bank activities through the federal regulatory framework.

Depending on the specific activity, at least seven federal regulators—(1) the Federal Reserve; (2) the FDIC; (3) the SEC;[61] (4) the Commodity Futures Trading Commission (CFTC); (5) the Consumer Financial Protection Bureau (CFPB); (6) the Federal Housing Finance Agency (FHFA); and (7) various agencies within the U.S. Treasury Department[62]—could supervise, examine, or otherwise regulate a bank.[63] One way to make sense of the massive regulatory framework is to broadly group the regulatory functions as follows: (1) chartering and entry restrictions; (2) regulation and supervision; and (3) examination.[64]

In most cases, banks are supervised and examined by more than one regulator. In general, federally chartered banks are subject to supervision by the Office of the Comptroller of the Currency (OCC). State-chartered banks that are members of the Federal Reserve System are subject to oversight by both the Federal Reserve Board and by state regulators. Non-Fed-member state-chartered banks that are insured by the FDIC are regulated by the FDIC and state regulators.

Additionally, the Fed is the primary regulator of all bank holding companies, even though such holding companies are also subject to state regulations.[65] Separately, a statutory formula generally dictates many specific responsibilities for the various federal banking regulators. For example, the Federal Deposit Insurance Act[66] defines the "appropriate Federal banking agency" for purposes of which agency regulates which bank,[67] and determines which federal agency is responsible for approving bank mergers.[68] Each federal regulator has wide discretion to regulate financial institutions under its jurisdiction.

Separately, the 2010 Dodd–Frank Act created the Financial Stability Oversight Council and expanded the ability of federal regulators to impose regulations on the financial sector in the name of promoting the ill-defined concept of financial stability.[69] The FSOC is a 15-member council that includes 10 voting seats and five nonvoting positions. The 10 voting seats are filled by the heads of nine federal financial regulatory agencies, including the Treasury Secretary (serving as the Chair of the FSOC) and the Chair of the Federal Reserve.[70] The FSOC's main purpose is to identify risks to the financial system and to recommend regulations to primary financial regulators, but it can require the Fed to regulate certain nonbank financial firms. Moreover, one of its explicit (yet undefined) purposes is "to respond to emerging threats to the stability of the United States financial system."[71]

Thus, there are many federal agencies that could potentially impose climate-change-related regulations on both banks and nonbank financial firms. The following list describes the main pathways—which are not mutually exclusive—for regulators to implement such regulatory actions.

The Examination Process. Federal regulators examine banks, depending on the size of the institution, at least once per 18-month period.[72] At these on-site "full-scope" inspections, federal examiners give each bank a CAMELS rating under the Uniform Financial Institutions Rating System.[73] The letters in the CAMELS acronym stand for capital adequacy, asset quality, management capability, earnings quality (and level), liquidity adequacy, and sensitivity to market risk.[74] Both component and composite ratings are given on a scale of 1 to 5, with 1 indicating the strongest rating and 5 the weakest. Examiners have a great deal of discretion in calculating the CAMELS ratings, and each "component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components."[75]

The CAMELS rating is much more than a mere supervisory tool. A poor rating can affect a bank's ability to operate, as well as its operating costs. For instance, the composite CAMELS rating helps to determine a bank's eligibility for primary credit at the Fed's discount window,[76] and regulators can use a poor rating to deny approval for mergers and acquisitions.[77] The FDIC deposit insurance assessment also depends, in part, on the composite CAMELS rating and a weighted average of the component ratings.[78] The capital component rating—as well as, more broadly, the capital adequacy of the bank—can also trigger multiple regulatory restrictions on a bank's ability to operate, ranging from funding source and asset size constraints[79] to the inability to appoint new officers and directors.[80]

Capital Requirements. Federal banking agencies regulate banks' capital adequacy and have the discretion to define what constitutes adequate capital levels. Congress created this authority with the 1983 International Lending Supervision Act.[81] Each appropriate federal banking agency must establish minimum levels of capital for banks,[82] and the statutory law provides regulators wide discretion to accomplish this task. For instance, federal agencies can regulate banks' capital levels "by establishing minimum levels of capital" and "by using such other methods as the appropriate Federal banking agency deems appropriate."[83]

Failure to maintain adequate capital levels may "be deemed by the appropriate Federal banking agency, in its discretion, to constitute an unsafe and unsound practice,"[84] ultimately terminating a bank's ability to provide customers with FDIC deposit insurance.[85] Precisely what constitutes adequate capital is also a matter of regulatory discretion, and the statutory code explicitly gives regulators the authority to determine adequate capital levels as they judge "to be necessary or appropriate in light of the particular circumstances of the banking institution."[86]

The fact that the federal banking agencies have jointly decided to use the Basel III rules as their guidelines for the federal regulatory capital framework has provided much structure to the regulatory capital framework.[87] Still, this decision provides wide discretion within that structure. For instance, one key component of the Basel III rules is the risk-weighted capital requirements, whereby regulators determine which risk weights to apply to individual assets and activities. Not only does the Fed have discretion in developing risk weights, but,

> [i]f the Board determines that the risk-weighted asset amount calculated under this part by the Board-regulated institution for one or more exposures is not commensurate with the risks associated with those exposures, the Board may require the Board-regulated institution to assign a different risk-weighted asset amount to the exposure(s) or to deduct the amount of the exposure(s) from its regulatory capital.[88]

The Federal Reserve also has the authority to apply capital planning and stress testing requirements to any top-tier bank holding company with total assets of at least $100 billion,[89] as well as to apply capital adequacy requirements to any state member bank and U.S. bank holding company.[90] Separately, federal banking law explicitly provides that the

> Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury shall encourage governments, central banks, and regulatory authorities of other major banking countries to work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending.[91]

Thus, regulators have a great deal of leeway to implement higher capital requirements for specific types of activities or assets that they deem risky.

Reputational Risk. Starting in the 1990s, federal banking agencies began to identify "reputational risk" as part of their broader efforts to manage financial institutions' overall risks.[92] Since that time, most federal agencies have clarified their views on reputational risks.[93] Subsequently, both the FDIC and the OCC have justified forcing banks to change their operating behavior based on concerns over reputational risk.[94]

According to the OCC, "[r]eputation risk is the risk to current or projected financial condition and resilience arising from negative public opinion," and "[r]eputation risk is inherent in all bank activities."[95] According to the OCC's examination handbook, examiners now consider a bank's "quantity of reputation risk and quality of reputation risk management."[96] These risks include many different factors, ranging from the "types of third-party relationships" and the "types of assets" that are under management, to the "market's or public's perception of the quality of the bank's products" and the "market's or public's perception of the bank's financial stability."[97]

Similarly, the Fed's official guidance states: "Principles of sound management should apply to the entire spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk."[98] The Fed defines reputational risk as "the potential that negative publicity regarding an institution's business practices, *whether true or not*, will cause a decline in the customer base, costly litigation, or revenue reductions."[99] (Emphasis added.)

The FDIC has not been as explicit in defining reputational risks, but its examination manual states that (1) reputation risk is one factor in assessing asset quality; (2) the institution's reputation can be damaged from noncompliance with consumer protection laws; and (3) "[d]epending on the nature and scope of an institution's activities, management practices may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance, legal, liquidity, and other risks."[100]

Regardless, there is precedent for enforcement actions based on reputational risks. Both the OCC and the FDIC, for instance, have forced banks to close customer accounts based on concerns over reputational risks.[101]

For their part, the FDIC has had a controversial history with the payday lending industry that dates to at least 2003. According to an FDIC Inspector General Report, the

> FDIC's payday lending guidance, which was established in 2003 and updated in 2005, increased expectations and placed heightened scrutiny on institutions that were engaged in payday lending. As a result of the guidance and related supervisory actions, the relatively few FDIC-supervised institutions that were making payday loans stopped doing so in 2006.[102]

The FDIC's 2003 guidance warns banks of dealing directly with payday lenders and even with third-party firms that deal with payday lenders. It states that "institutions face increased reputation risks when they enter into certain arrangements with payday lenders, including arrangements to originate loans on terms that could not be offered directly, by, the payday lender."[103] It also warns that "[p]ayday lending raises many consumer protection issues and attracts a great deal of attention from consumer advocates and other regulatory organizations, increasing the potential for litigation."[104]

Regulators also have wide discretion in how they remedy problems with compliance. For instance, the FDIC's guidance states,

> Examiners will work with institutions on a case-by-case basis to determine appropriate supervisory actions necessary to address concentrations. Such action may include directing the institution to reduce its loans to an appropriate level, raise additional capital, or submit a plan to achieve compliance.[105]

In 2005, the FDIC revised this guidance to limit the specific terms under which banks could provide payday loans to customers.[106]

The FDIC's interactions with payday lenders gained widespread notoriety in 2013 through Operation Chokepoint, a Department of Justice (DOJ) initiative that (ostensibly) was "intended to protect consumers from fraud perpetrated by fraudulent merchants, financial institutions, and financial intermediaries known as third-party payment processors (TPPP)."[107] Amidst numerous public reports, several Members of Congress expressed concern over the FDIC working with the DOJ to pressure banks into denying accounts to customers in certain "high-risk" industries.[108] Ultimately, the Inspector General absolved the FDIC of any major wrongdoing in Operation Chokepoint, and its report shows just how much discretion the FDIC has in such regulatory matters:

> We determined that the FDIC's supervisory approach to financial institutions that conducted business with merchants on the high-risk list was within the Corporation's broad authorities granted under the FDI Act and other relevant statutes and regulations. However, the manner in which the supervisory approach was carried-out was not always consistent with the FDIC's written policy and guidance. We found no evidence that the FDIC used the high-risk list to target financial institutions. However, references to specific merchant types in the summer 2011 edition of the FDIC's Supervisory Insights Journal and in supervisory guidance created a perception among some bank executives that we spoke with that the FDIC discouraged institutions from conducting business with those merchants. This perception was most prevalent with respect to payday lenders.... The heightened level of concern for payday lending by financial institutions and related ACH [automated clearing house] processing was reflected in the negative tenor of internal email communications among senior FDIC staff and others that we reviewed. In some cases, these communications involved instances in which FDIC personnel contacted institutions and used moral suasion to discourage them from adopting payday lending products or providing ACH processing for payday lenders. The FDIC does not have a formal definition of moral suasion in its policies. However, examiners commonly use moral suasion in an attempt to influence risk management practices at financial institutions before perceived problems rise to a level that necessitates an informal or formal enforcement action.[109]

Eventually, the FDIC changed its guidance and clarified its policy, explaining that its internal policy does not allow termination of customer deposit accounts based *solely* on reputational risks.[110] Nonetheless, the FDIC clearly has the authority to create a new guidance policy that changes its current stance on reputational risk. Even without a formal rulemaking, this type of policy can clearly affect a bank's willingness to do business with certain customers. Moreover, the Fed and the OCC have similar authority and guidance that warns banks of dealing with third parties that might harm the banks' reputation.[111] As with payday lending and Operation Chokepoint, banks are very hesitant to push back against any sort of pressure from federal regulators.

Unsafe or Unsound Practices. The FDIC has an enormous amount of leverage over financial institutions because it can terminate a bank's status as an *insured* depository institution if it finds that the bank has engaged in or is "engaging in unsafe or unsound practices in conducting the business of such depository institution."[112] The FDIC, along with the other federal banking agencies, is responsible for determining what constitutes unsafe or unsound practices. When regulators determine that an insured depository institution has (or is about to) engage in an unsafe or unsound practice, they can issue a "cease and desist" order.[113] The law explicitly gives federal regulators "the authority to place limitations on the activities or functions of an insured depository institution or any institution-affiliated party."[114]

Lending Limits. Federal law limits how much money a bank can lend to any one customer or to a group of related customers. For loans and extensions of credit that are not fully secured with collateral, the total "to a person outstanding at one time" may not exceed 15 percent "of the unimpaired capital and unimpaired surplus" of the bank.[115] For those that are fully secured, the total cannot exceed 10 percent, but this restriction is "separate from and in addition to" the limitation on loans that are not fully secured.[116] The OCC has the authority to promulgate rules and regulations for these lending limits for national banks, including "rules or regulations to define or further define terms used in this section," as well as "to establish limits or requirements *other than those specified in this section* for particular classes or categories of loans or extensions of credit."[117] (Emphasis added.) Thus, the OCC has the explicit authority to promulgate a rule that further restricts the types of loans that national banks are allowed to make.

The Community Reinvestment Act (CRA). The CRA[118] was passed in 1977 when banks were the main funding source for home loans, and banks operated in a less competitive environment.[119] Under this law, each federal banking regulator is required "to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."[120]

The law has long been a source of intense debate, partly because it allows regulators to apply vague and inconsistent standards to, for example, putting a hold on mergers, acquisitions, and expansions, as well as to, (in effect) allocating credit.[121] Some groups are pushing regulators to update the CRA in order to "spur lending, investment, and other services that address climate resilience in low-income communities of color, which are particularly vulnerable to extreme weather and climate-related events."[122]

Dodd–Frank, Section 165. Section 165 of the 2010 Dodd–Frank Act[123] requires the Federal Reserve Board of Governors (on its own, or pursuant to recommendations by the FSOC)[124] to develop prudential regulatory standards for the nonbank financial firms they supervise as well as bank holding companies with assets equal to or greater than $250 billion.

The purpose of these special regulations is "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions."[125] The law requires that these regulations be "more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States,"[126] and that they "increase in stringency, based on the considerations identified in subsection (b)(3)."[127]

Subsection (b)(3) requires the board to consider several factors when developing the special regulations. These factors include differences in the companies based on (among other things) "nonfinancial activities and affiliations of the company,"[128] and "*any other* risk-related factors that the Board of Governors determines appropriate."[129] (Emphasis added.) The law also requires the board to "take into account any recommendations"[130] of the FSOC, as well as to consider differences based on "the factors described in subsections (a) and (b) of section 5323 of this title."[131]

This last set of factors (in "section 5323 of this title")[132] refers to Section 113 of Dodd–Frank, the FSOC's authority to designate nonbank financial companies for prudential regulations.[133] As Section 115 of Dodd–Frank states, the purpose of recommending these prudential standards is "to prevent or mitigate risks to the *financial stability* of the United States that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions."[134] (Emphasis added.) The law does not define "financial stability," so it gives the FSOC a great deal of flexibility to make such recommendations. While the FSOC cannot directly implement these prudential standards, it can explicitly make recommendations to the Board of Governors "concerning the establishment and refinement" of the regulations.[135]

When making its recommendations to the board, the FSOC also has the explicit authority to "differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and *any other risk-related factors that the Council deems appropriate*."[136] (Emphasis added.) The law also lists several specific factors that the FSOC should use to develop the prudential standards, including a company's leverage and off-balance-sheet exposures, as well as "the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company,"[137] and "*any other* risk-related factors that the Council deems appropriate."[138] (Emphasis added.) Separately, Dodd–Frank states that the FSOC's recommendations may include items such as "risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits," and also "enhanced public disclosures, short-term debt limits, and overall risk management requirements."[139]

In 2019, the Fed released its final rule on prudential standards for large bank holding companies.[140] This rule, which might provide a clue to how regulators could structure climate-related regulations, establishes "four categories to apply enhanced standards based on indicators designed to measure the risk profile of a banking organization."[141] The categories are essentially based on size, with progressively more stringent requirements applied to the larger banks.[142] The most stringent prudential regulations are under Category I, and they are reserved for U.S.-based global systemically important banks (GSIBs).

The specific standards for the GSIBs are essentially those agreed on by the international Basel Committee on Banking Supervision (BCBS). They include a special GSIB capital surcharge, an enhanced supplementary leverage ratio, stress tests, liquidity standards, and counterparty limits.[143] The (less stringent) standards for Category II apply to banks with $700 billion or more in total assets that are not GSIBs. The standards for Category III apply to banks with $250 billion or more in assets (that are not in the first two categories), and those for Category IV apply to banks with $100 billion or more (that are not in Categories I, II, or III).[144]

Regarding nonbank financial firms, the FSOC recently issued guidance explaining its "activities based" approach to identifying, assessing, and addressing "potential risks and emerging threats on a system-wide basis."[145] According to that guidance, the FSOC will "pursue entity specific determinations under Section 113 of the Dodd–Frank Act only if a potential risk or threat cannot be adequately addressed through an activities-based approach."[146] (Section 113 recommendations are discussed below.) Also, according to the same guidance, the FSOC will only make Section 120 recommendations after determining whether the primary regulatory agency for a given company would conduct a cost-benefit analysis based on the recommendations.[147] (Section 120 recommendations are discussed below.)

As the guidance explains, in order to implement the FSOC's activities-based approach for nonbank financial firms, the FSOC will "examine a diverse range of financial products, activities, and practices that could pose risks to U.S. financial stability."[148] The guidance also notes that the FSOC's "annual reports highlight the types of activities the Council will evaluate," and that these activities include "the extension of credit, maturity and liquidity transformation, market making and trading, and other key functions critical to support the functioning of financial markets."[149]

Although the FSOC has not recommended specific heightened regulations for such activities yet, it has "evaluated" risks, such as "cybersecurity events associated with the increased use of information technology, the concentrations of activities and exposures in central counterparties, and transition issues related to the move away from LIBOR [London Interbank Offered Rate]."[150] Thus, it would not be at all unusual—and not outside the scope of its authority—for the FSOC to, at the very least, evaluate the risks associated with climate change.

Dodd–Frank, Section 113. This section of Dodd–Frank[151] gives the FSOC the authority to determine "that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards," provided that the FSOC determines "that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States."[152] As mentioned, the law does not define "financial stability." Under current policy, the FSOC generally pursues an activities-based approach for Section 113 recommendations, rather than singling out specific firms. The FSOC could, however, easily change that stance.

Dodd–Frank, Section 120. This section of Dodd–Frank gives the FSOC the explicit authority to make recommendations to "the primary financial regulatory agencies" to apply heightened regulations. Specifically, the FSOC can make such recommendations "for a financial activity or practice conducted by bank holding companies or nonbank financial companies" if the FSOC determines that "the conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities."[153]

The FSOC has not yet issued such standards, but Dodd–Frank states that these regulations can include those enumerated in Section 115 of Dodd–Frank.[154] Therefore, the standards can include items ranging from overall risk-management requirements to leverage limits.[155]

Combined, these sections of Dodd–Frank give the FSOC and the Board of Governors a great deal of flexibility to develop prudential regulations for anything that they qualify as a risk factor, including climate change. However, even if Congress repealed the Dodd–Frank Act in its entirety, federal financial regulators would still have enormous flexibility to develop and implement climate-risk-related regulations for banks.

Policy Recommendations

Policymakers should oppose efforts to redefine the purpose of business in the name of social justice; corporate social responsibility (CSR); stakeholder theory; environmental, social, and governance (ESG) criteria; socially responsible investing (SRI); sustainability; diversity; business ethics; or common-good capitalism. The purpose of business enterprises should be determined privately.

For purposes of the securities laws, the focus of the materiality standard should remain on what investors need to know to meet their financial, economic, or pecuniary objectives, not the preferred political or social objectives of a regulator, proxy advisory firm, investment advisers, or fiduciary. Congress should statutorily define materiality in terms generally consonant with Supreme Court holdings on the issue, and should specifically exclude social and political objectives unrelated to investors' financial, economic, or pecuniary objectives.[156]

Furthermore:

- **Congress and the regulatory agencies**[157] **need to make it clear that managers of retirement funds or accounts, and investment advisers managing investment funds, have a duty to manage those funds** and vote the shares held by the funds or accounts in the financial, economic, or pecuniary interest of millions of small investors, and not in furtherance of managers' preferred social or political objectives. The law governing fiduciary duties should specifically exclude social and political objectives that are unrelated to investors' financial, economic, or pecuniary objectives.

- **Congress should require banking regulators to consider solely economic and financial factors when promulgating regulations,** rather than factors that might affect the public's view of a bank. Congress should reassert its control over financial policy and reduce the regulatory authority and discretion of financial regulators. Repealing Title 1 of the Dodd–Frank Act, thus eliminating the FSOC, is but one step in a positive direction.[158]

- **Congress should prohibit banking regulators from considering social or political objectives, including climate change, in the supervision and examination of banks or credit unions** regarding assets rating, capital adequacy, reputational risk, lending limits, "prudential" standards, and financial stability.

- **Policymakers should oppose efforts to allocate capital or credit based on political or social objectives, including climate-change objectives.** They should oppose efforts to establish a National Climate Bank or a Clean Energy and Sustainability Accelerator.

Conclusion

The Biden Administration is actively seeking to fight climate change through financial regulation. A May 20, 2021, executive order, which directs agency officials to deliver recommendations to the President by November 2021, is the Administration's latest action. Although it remains unclear exactly what the Administration and regulatory agencies will do, it is clear that the existing financial regulatory framework provides more than enough authority to implement a wide variety of new climate-related regulations. Even without the new provisions from the Dodd–Frank Act, the U.S. Code provides enormous discretion to independent regulatory agencies.

The types of regulations that officials are discussing can be expected to raise costs to both consumers and businesses, create barriers to entry that help large incumbent firms by reducing competition, reduce the productivity and competitiveness of U.S. employers, harm wages, and have other adverse social consequences. As a strategy to mitigate climate change, such types of financial regulations—including new taxes, disclosure requirements, and other capital market regulation—are poorly conceived, as they will have virtually no impact on climate change. They are primarily about virtue signaling, creating political pressure on companies to further progressive political and social goals, and the ability to grant regulatory favor to politically connected businesses.

The existing regulatory framework is highly flawed, and it gives federal financial regulators multiple avenues for imposing climate-related regulations, even though they will likely be based on highly imprecise metrics and ill-defined concepts. Given the enormous uncertainties surrounding climate-change predictions and the tenuous connection between financial disclosure and, for example, emissions, regulations based on such estimates are unlikely to affect the climate—but are certain to have an adverse impact on the economy.

Of course, there can be little doubt that these regulations will result in an army of well-paid consultants, lawyers, and accountants who will provide compliance advice, and that those living off this compliance ecosystem will become effective lobbyists for maintenance of the system.

A much better approach is to allow companies to gauge their own risks without new government mandates, and to determine which of their risks are material to investors. The government should not be in the business of allocating credit to politically favored interests, and regulatory agencies should not have the enormous level of discretion that they currently do.

Norbert J. Michel, PhD, is Director of the Center for Data Analysis, of the Institute for Economic Freedom, at The Heritage Foundation. **David R. Burton** is Senior Fellow in Economic Policy in the Thomas A. Roe Institute for Economic Policy Studies, of the Institute for Economic Freedom. **Nicolas D. Loris** (former Deputy Director of the Roe Institute) is Vice President of Public Policy at C3 Solutions.

Endnotes

1. "It is the policy of my Administration to organize and deploy the full capacity of its agencies to combat the climate crisis to implement a Government-wide approach that reduces climate pollution in every sector of the economy." See The White House, "Executive Order on Tackling the Climate Crisis at Home and Abroad," January 27, 2021, https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/27/executive-order-on-tackling-the-climate-crisis-at-home-and-abroad/ (accessed May 27, 2021); The White House, "Executive Order on the Revocation of Certain Presidential Actions," February 24, 2021, https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-the-revocation-of-certain-presidential-actions/ (accessed May 27, 2021) (revoking Executive Order 13772 of February 3, 2017, "Core Principles for Regulating the United States Financial System"); seeking recommendations from agencies under the rubric of "modernizing regulatory review" providing "concrete suggestions on how the regulatory review process can promote public health and safety, economic growth, social welfare, racial justice, environmental stewardship, human dignity, equity, and the interests of future generations." See The White House, "Memorandum on Modernizing Regulatory Review," January 20, 2021 https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/modernizing-regulatory-review/ (accessed May 27, 2021); The White House, "Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis," January 20, 2021, https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/executive-order-protecting-public-health-and-environment-and-restoring-science-to-tackle-climate-crisis/ (accessed May 27, 2021); and The White House, "Executive Order on Revocation of Certain Executive Orders Concerning Federal Regulation," January 20, 2021, https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/executive-order-revocation-of-certain-executive-orders-concerning-federal-regulation/ (accessed May 27, 2021).
2. The White House, "Executive Order on Climate-Related Financial Risk," May 20, 2021, https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/ (accessed May 27, 2021).
3. An assistant to the President.
4. The Financial Stability Oversight Council consists of 10 voting members and five nonvoting members. The voting members are:
   1. The Secretary of the Treasury (who serves as Chairman of the council);
   2. The Chairman of the Board of Governors of the Federal Reserve System;
   3. The Comptroller of the Currency (OCC);
   4. The Director of the Consumer Financial Protection Bureau (CFPB);
   5. The Chairman of the Securities and Exchange Commission (SEC);
   6. The Chairman of the Federal Deposit Insurance Corporation (FDIC);
   7. The Chairman of the Commodity Futures Trading Commission (CFTC);
   8. The Director of the Federal Housing Finance Agency (FHFA);
   9. The Chairman of the National Credit Union Administration (NCUA); and
   10. An independent member with insurance expertise who is appointed by the President and confirmed by the Senate for a six-year term. See U.S. Department of the Treasury, "About FSOC," https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/about-fsoc (accessed May 27, 2021).
5. Emily Glazer, "Companies Brace Themselves for New ESG Regulations Under Biden," *The Wall Street Journal*, January 18, 2021.
6. For an overview of the congressional debate, see "21st Century Economy: Protecting the Financial System from Risks Associated with Climate Change," hearing before the U.S. Senate Committee on Banking, Housing, and Urban Development, March 18, 2021, https://www.banking.senate.gov/hearings/21st-century-economy-protecting-the-financial-system-from-risks-associated-with-climate-change (accessed May 27, 2021).
7. Investment advisers are regulated primarily by the Investment Advisers Act of 1940. The act spells adviser with an "e."
8. See, for example, Sec. 12401 of H. R. 4447, 116th Congress, the Clean Economy Jobs and Innovation Act, which was passed by the House on September 24, 2020 ($20 billion); S. 283, 117th Congress, the National Climate Bank Act ($100 billion). See also Paul H. Tice, "The Trouble with Biden's 'Green Bank,'" *The Wall Street Journal*, May 23, 2021. Also see Jason Isaac, "A Bad Deal: National Climate Bank Act," testimony before the Clean Air, Climate, and Nuclear Safety Subcommittee, Committee on Environment and Public Works, U.S. Senate, April 27, 2021, https://www.texaspolicy.com/s-283-the-national-climate-bank-act/ (accessed May 26, 2021).
9. Public statement by Allison Herren Lee, "Public Input Welcomed on Climate Change Disclosures," U.S. Securities and Exchange Commission, March 15, 2021, https://www.sec.gov/news/public-statement/lee-climate-change-disclosures (accessed May 27, 2021), and Fred Lucas, "SEC's Gary Gensler Eyes Crypto and Climate Change with Confirmation Official," Fox Business, April 14, 2021, https://www.foxbusiness.com/markets/secs-gary-gensler-confirmed-crypto-and-climate-change-top-his-agenda (accessed May 27, 2021).
10. Paul Kiernan, "U.S. Treasury Creates Climate Hub to Coordinate Policy," *The Wall Street Journal*, April 19, 2021, https://www.wsj.com/articles/u-s-treasury-creates-climate-hub-to-coordinate-policy-11618851657 (accessed May 27, 2021).
11. News release, "Remarks by Secretary of the Treasury Janet L. Yellen on International Priorities to the Chicago Council on Global Affairs," U.S. Department of the Treasury, April 5, 2021, https://home.treasury.gov/news/press-releases/jy0101 (accessed May 27, 2021).
12. This claim refers to energy intensity (units of energy per unit of gross domestic product). See U.S. Energy Information Administration, "U.S. Energy-Related Carbon Dioxide Emissions, 2019," September 30, 2020, https://www.eia.gov/environment/emissions/carbon/ (accessed May 26, 2021).

13. Tanya Fiedler et al., "Business Risk and the Emergence of Climate Analytics," *Nature Climate Change*, Vol. 11 (February 2021), pp. 87–94, https://www.nature.com/articles/s41558-020-00984-6.epdf?sharing_token=KA_3fz0ShR9hqtb0XjVimdRgN0jAjWel9jnR3ZoTv0OSOZnKsSGMjP8867r_gOdtNaRkMlMK7aivZ2uhHDtFpU8uzvrzZHEujYqrZlJ5sTGgeE_X9odvXU60-2GY_AVrWtbp9ssBRiWWgCHv-o_hX-pTL0UJNJnCFyYVojc8eCI%3D (accessed May 27, 2021).
14. Matthew Green, "Scientists Warn Over Misuse of Climate Models in Financial Markets," Reuters, February 8, 2021, https://www.reuters.com/article/us-climate-change-investors/scientists-warn-over-misuse-of-climate-models-in-financial-markets-idUSKBN2A81TU (accessed May 27, 2021).
15. Zack Coleman, "'Garbage' Models and Black Boxes? The Science of Climate Disaster Planning," *Politico*, March 21, 2021, https://www.politico.com/news/2021/03/16/climate-change-murky-models-476316 (accessed May 27, 2021).
16. Green, "Scientists Warn Over Misuse of Climate Models in Financial Markets."
17. A foundational resource is the U.N. Intergovernmental Panel on Climate Change's (IPCC's) Coupled Model Intercomparison Project phase 5 (CMIP5), an ensemble of models used by the IPCC. There is significant disagreement within these models even over core issues, such as estimating the climate effects of cloud cover and aerosols—so much so that the IPCC has noted that the CMIP5 ensemble "cannot be taken as a reliable regional probability forecast." Working Group I, "Climate Change 2013: The Physical Science Basis," in *Fifth Assessment Report of the Intergovernmental Panel on Climate Change* (New York: Cambridge University Press, 2013), p. 1013, https://www.ipcc.ch/site/assets/uploads/2018/02/WG1AR5_all_final.pdf (accessed June 14, 2021). Also see Katie Tubb, public comment to the U.S. Securities and Exchange Commission, June 11, 2021, pp. 3–5, https://www.sec.gov/comments/climate-disclosure/cll12-8907322-244259.pdf (accessed June 14, 2021).
18. Justin Ritchie and Hadi Dowlatabadi, "Why Do Climate Change Scenarios Return to Coal?" *Energy*, Vol. 140, Part 1 (December 2017), pp. 1276–1291, https://www.sciencedirect.com/science/article/abs/pii/S0360544217314597 (accessed June 10, 2021).
19. Roger Pielke and Justin Ritchie, "Systemic Misuse of Scenarios in Climate Research and Assessment," SSRN, April 21, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3581777 (accessed June 10, 2021).
20. See, for instance, Byron A. Steinman, Michael E. Mann, and Sonya K. Miller, "Atlantic and Pacific Multidecadal Oscillations and Northern Hemisphere Temperatures," *Science*, Vol. 347, No. 6225 (February 2015), pp. 988–991, https://science.sciencemag.org/content/347/6225/988#aff-1 (accessed June 10, 2021), and Joseph Majkut, "Climbing the Staircase of Global Warming," Niskanen Center, July 27, 2016, https://www.niskanencenter.org/climbing-staircase-global-warming/ (accessed June 10, 2021).
21. Kevin Dayaratna, Ross McKitrick, and David Kreutzer, "Empirically Constrained Climate Sensitivity and the Social Cost of Carbon," *Climate Change Economics*, Vol. 8, No. 2 (2017), pp. 1–12, https://econpapers.repec.org/article/wsiccexxx/v_3a08_3ay_3a2017_3ai_3a02_3an_3as2010007817500063.htm (accessed June 10, 2021).
22. U.S. Securities and Exchange Commission, "What We Do: Introduction," http://www.sec.gov/about/whatwedo.shtml#intro (accessed June 12, 2021). The statutory charge is: "Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." See § 3(f) of the Securities Exchange Act of 1934 and § 2(b) of the Securities Act of 1933.
23. A transaction induced by fraud (misrepresentation) is not voluntary or welfare-enhancing in that it would not be entered into in the absence of the fraud (or would be entered into at a different price). This principle has long been recognized as common law and is recognized by virtually all political theorists. Securities fraud was illegal long before New Deal securities laws, or even blue sky laws, were enacted. Stuart Banner, *Anglo-American Securities Regulation: Cultural and Political Roots, 1690–1860* (New York: Cambridge University Press, 2002). See also Frank H. Easterbrook and Daniel R. Fischel, "Mandatory Disclosure and the Protection of Investors," *Virginia Law Review*, Vol. 70 (1984), p. 669–715, http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2176&context=journal_articles (accessed June 12, 2021).
24. *Restatement of the Law, Second, Torts, Volume 3* (Philadelphia: American Law Institute, 1977).
25. Securities Exchange Act of 1934, section 10(b) [15 U.S. Code § 78j]. Regulation of the Use of Manipulative and Deceptive Devices. See also 17 CFR 240.10b-5, Employment of manipulative and deceptive devices.
26. See, for example, section 501 of the Uniform Securities Act (2002).
27. For a general introduction, see Richard A. Posner, "Financial Markets," in *Economic Analysis of the Law*, various editions, the most recent being the 9th Edition (New York: Wolters Kluwer Law & Business, 2014).
28. Robert A. Prentice, "The Economic Value of Securities Regulation," *Cardozo Law Review* Vol. 28, No. 1 (2006), pp. 333–389, http://cardozolawreview.com/Joomla1.5/content/28-1/cross.website.pdf (accessed June 12, 2021); Bernard S. Black, "The Legal and Institutional Preconditions for Strong Securities Markets," *UCLA Law Review*, Vol. 48 (2001), pp. 781–855, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=182169 (accessed June 12, 2021); and Luca Enriques and Sergio Gilotta, "Disclosure and Financial Market Regulation," in Eilís Ferran, Niamh Moloney, and Jennifer Payne, eds., *The Oxford Handbook on Financial Regulation* (Oxford, U.K.: Oxford University Press, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768 (accessed June 12, 2021).
29. Marcel Kahan, "Securities Laws and the Social Cost of 'Inaccurate' Stock Prices," *Duke Law Journal*, Vol. 41, No. 5 (1992), pp. 977–1044, http://scholarship.law.duke.edu/dlj/vol41/iss5/1/ (accessed June 12, 2021); John C. Coffee, Jr., "Market Failure and the Economic Case for a Mandatory Disclosure System," *Virginia Law Review*, Vol. 70 (1984), pp. 717–753; and Joel Seligman, "The Historical Need for a Mandatory Corporate Disclosure System," *Journal of Corporation Law*, Vol. 9, No. 1 (1983), p. 1, reprinted in F. E. Gill, ed., *Selected Articles on Federal Securities Law* (Chicago: American Bar Association Section of Business Law, 1991).

30. Jeffrey Wurgler, "Financial Markets and the Allocation of Capital," *Journal of Financial Economics*, Vol. 58, No. 187 (2000), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1972124&download=yes (accessed June 10, 2021); R. David Mclean, Tianyu Zhang, and Mengxin Zhao, "Why Does the Law Matter? Investor Protection and its Effects on Investment, Finance, and Growth," *The Journal of Finance*, Vol. 67, No. 1 (2021), pp. 313–350; Ronald A. Dye, "Mandatory Versus Voluntary Disclosures: The Cases of Financial and Real Externalities," *The Accounting Review*, Vol. 65, No. 1 (1990), pp. 1–24; Brian J. Bushee and Christian Leuz, "Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board," *Journal of Accounting and Economics*, Vol. 39, No. 2 (2005), pp. 233–264, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=530963 (accessed June 10, 2021); Joseph A. Franco, "Why Antifraud Provisions Are Not Enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure," *Columbia Business Law Review*, Vol. 2002, No. 2, pp. 223–362, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=338560 (accessed June 10, 2021); Paul M. Healy and Krishna G. Palepu, "Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature," *Journal of Accounting and Economics*, Vol. 31 (2001), pp. 405–440, http://tippieweb.iowa.uiowa.edu/accounting/mcgladrey/winterpapers/kothari1.pdf (accessed June 10, 2021); and Anat R. Admati and Paul C. Pfleiderer, "Forcing Firms to Talk: Financial Disclosure Regulation and Externalities," *Review of Financial Studies*, Vol. 13, No. 3 (Autumn 2000), pp. 479–519, https://faculty-gsb.stanford.edu/admati/documents/Forcingfirmstotalk_research.pdf (accessed June 10, 2021).
31. Christine A. Botosan, "Evidence That Greater Disclosure Lowers the Cost of Equity Capital," *Journal of Applied Corporate Finance*, Vol. 12, No. 4 (2000), pp. 60–69, reprinted in Donald H. Chew, Jr., and Stuart L. Gillan, eds., *Corporate Governance at the Crossroads: A Book of Readings* (New York: McGraw-Hill/Irwin, 2005), and Charles P. Himmelberg, R. Glenn Hubbard, and Inessa Love, "Investor Protection, Ownership, and the Cost of Capital," SSRN, February 12, 2002, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=303969 (accessed June 10, 2021).
32. The interests of shareholders and management are often not coincident and may conflict considerably. This is often described as the agent-principal problem, or collective-action problem, and is significant in larger firms where ownership and management of the firm are separate. Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics*, Vol. 3, No. 4 (1976), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043 (accessed June 10, 2021); Paul G. Mahoney, "Mandatory Disclosure as a Solution to Agency Problems," *University of Chicago Law Review*, Vol. 62, No. 3 (1995), pp. 1047–1112; and Merritt B. Fox, "Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment," *Virginia Law Review*, Vol. 85, No. 7 (1999), pp. 1335–1419.
33. Requiring certain written affirmative representations in public disclosure documents deters fraud because proving fraud becomes easier if the public, written representations are later found by a trier of fact to be inconsistent with the facts.
34. Roberta Romano, *The Advantage of Competitive Federalism for Securities Regulation* (Washington, DC: AEI Press, 2002), and Healy and Palepu, "Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature," pp. 405–440.
35. Frank Easterbrook and Daniel Fishel, *The Economic Structure of Corporate Law* (Cambridge, MA: Harvard University Press, 1991); Michael J. Fishman and Kathleen M. Hagerty, "Disclosure Decisions by Firms and the Competition for Price Efficiency," *The Journal of Finance*, Vol. 44, No. 3 (1989), pp. 633–646, http://www.jstor.org/stable/pdfplus/2328774.pdf (accessed June 12, 2021); George J. Stigler, "Public Regulation of the Securities Markets," *The Business Lawyer* Vol. 19, No. 3 (April 1964), pp. 721–753; and George J. Benston, "Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934," *American Economic Review*, Vol. 63, No. 1 (March 1973).
36. The Regulation D safe harbor imposes certain modest requirements if the issuer sells securities to any purchaser that is not an accredited investor. See 17 CFR § 230.502(b).
37. See, for example, Maureen O'Hara and David Easley, "Information and the Cost of Capital," *Journal of Finance*, Vol. 59, No. 4 (August 2004), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=300715 (accessed June 12, 2021).
38. 17 CFR Part 229.
39. 17 CFR Part 210.
40. David R. Burton, "Reducing the Burden on Small Public Companies Would Promote Innovation, Job Creation, and Economic Growth," Heritage Foundation *Backgrounder* No. 2924, June 20, 2014, http://www.heritage.org/research/reports/2014/06/reducing-the-burden-on-small-public-companies-would-promote-innovation-job-creation-and-economic-growth.
41. David R. Burton, "Congress Should Increase Access to Private Securities Offerings," Heritage Foundation *Issue Brief* No. 4899, August 29, 2018, https://www.heritage.org/sites/default/files/2018-08/IB4899.pdf.
42. Troy A. Paredes, "Blinded by the Light: Information Overload and Its Consequences for Securities Regulation," *Washington University Law Quarterly*, Vol. 81 (2003), pp. 417–485, https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1287&context=law_lawreview (accessed June 12, 2021), and Troy A. Paredes, "Remarks at The SEC Speaks in 2013," U.S. Securities and Exchange Commission, February 22, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1365171492408#.Ut2WJbROmM8 (accessed June 12, 2021). See also Keith F. Higgins, "Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting," U.S. Securities and Exchange Commission, April 11, 2014, http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#.VItSmXt4zYg (accessed June 12, 2021).
43. U.S. Securities and Exchange Commission, "Business and Financial Disclosure Required by Regulation S-K," April 13, 2016, p. 33, https://www.sec.gov/rules/concept/2016/33-10064.pdf (accessed June 12, 2021), and "Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission," Committee Print 95-29, Committee on Interstate and Foreign Commerce, U.S. House of Representatives, 95th Cong., 1st Sess., November 3, 1977, http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1977_1103_AdvisoryDisclosure.pdf (accessed June 12, 2021).

44. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), and *Basic Inc. vs. Levinson*, 485 U.S. 224 (1988).
45. *Matrixx Initiatives, Inc. v. Siracusano*, 131 U.S. 1309 (2011).
46. See, for example, Allison Herren Lee, "Living in a Material World: Myths and Misconceptions About 'Materiality,'" U.S. Securities and Exchange Commission, May 24, 2021, https://www.sec.gov/news/speech/lee-living-material-world-052421?utm_medium=email&utm_source=govdelivery#_ftnref37 (accessed June 12, 2021).
47. Institutional Shareholder Services, Inc. (ISS) (located in Rockville, MD, a suburb of Washington, DC) and Glass, Lewis & Co., LLC (located in San Francisco, CA) control about 97 percent of the proxy advisory business (61 percent for ISS and 36 percent for Glass Lewis). Egan-Jones Proxy Service, Segal Marco Advisors, and ProxyVote Plus are much smaller competitors. See James K. Glassman and J. W. Verret, "How to Fix Our Broken Proxy Advisory System," Mercatus Center, George Mason University, April 16, 2013, https://www.mercatus.org/system/files/Glassman_ProxyAdvisorySystem_04152013.pdf (accessed June 12, 2021) ("Between them, ISS and Glass Lewis clients control 25 percent to 50 percent of the typical mid-cap or large-cap company's shares, according to a study by a proxy solicitation firm" (p. 20). "The proxy advisory industry was principally created by regulation. Without regulatory mandates requiring active participation in proxy votes, and without interpretative releases giving preferential treatment to investment managers who use proxy advisors, a profitable proxy advisory industry might not exist" (p. 26).); James K. Glassman and Hester Peirce, "How Proxy Advisory Services Became So Powerful," George Mason University, Mercatus Center *Policy Brief*, June 18, 2014, https://www.mercatus.org/system/files/Peirce-Proxy-Advisory-Services-MOP.pdf (accessed June 12, 2021) ("But regulation is the main impetus to vote proxies—and to rely on proxy advisory firms. In the absence of regulatory encouragement to use PAs, institutional investors might rationally choose not to vote, to vote consistently with management, or to vote only on key matters" (p. 1).); and David F. Larcker, Brian Tayan, and James R. Copland, "The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry," Harvard Law School Forum on Corporate Governance, June 14, 2018, https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/ (accessed June 12, 2021). See also Government Accountability Office, "Corporate Shareholder Meetings: Issues Relating to Firms That Advise Institutional Investors on Proxy Voting," June 2007, https://www.gao.gov/assets/gao-07-765.pdf (accessed June 12, 2021), and Government Accountability Office, "Corporate Shareholder Meetings Proxy Advisory Firms' Role in Voting and Corporate Governance Practices," November 2016, https://www.gao.gov/assets/gao-17-47.pdf (accessed June 12, 2021).
48. Yonca Ertimur, Fabrizio Ferri, and David Oesch, "Shareholder Votes and Proxy Advisors: Evidence from Say on Pay," *Journal of Accounting Research*, Vol. 51, No. 5 (December 2013), pp. 951–996 (pp. 3, 22, and 23 and Table 6 of the SSRN version), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019239 (accessed June 12, 2021), and Thomas Quaadman, "Legislative Proposals to Examine Corporate Governance," testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 28, 2018, https://www.banking.senate.gov/imo/media/doc/Quaadman%20Testimony%206-28-18.pdf (accessed June 12, 2021).
49. See data (as of April 27, 2021) at Mutual Fund Directory, "Mutual Fund Company List," Mutual Fund Companies ranked by Assets Under Management (AUM), data updated on April 27, 2021, https://mutualfunddirectory.org/latest-directory-ranking-here/ (accessed June 12, 2021).
50. Investment Company Institute, "2019 Facts at a Glance," *Investment Company Fact Book*, 60th Ed., 2020, p. ii, https://www.ici.org/system/files/attachments/pdf/2020_factbook.pdf (accessed June 12, 2021).
51. As of the first quarter of 2021, the top 15 mutual fund managers (ranked by net assets under management) were BlackRock, Vanguard Group, Charles Schwab, Fidelity Investments, State Street Global Advisors, PIMCO/Allianz, J.P. Morgan, Capital Group, BNY Mellon (Dreyfus), Amundi Asset Management, Prudential Investments, T. Rowe Price, Legal & General Investments, Franklin Templeton, and BofA Merrill Lynch. In the first quarter, 2021, these 15 firms had $50.6 trillion under management (invested in all securities worldwide). The total market capitalization of the U.S. stock market on March 31, 2021, was approximately $49 trillion. See Siblis Research, "Total Market Capitalization of Public U.S. Companies (USD, Millions)," https://siblisresearch.com/data/us-stock-market-value/ (accessed June 12, 2021). The Wilshire 5000 appreciated 5.5 percent between March 31 and April 27, 2021, implying a total U.S. stock market capitalization as of April 27 of about $52 trillion.
52. Broadridge Investor Communication Solutions and PricewaterhouseCoopers, "ProxyPulse: 2020 Proxy Season Review," 2020, p. 4, https://www.broadridge.com/_assets/pdf/broadridge-proxypulse-2020-review.pdf (accessed June 12, 2021).
53. Most important, the SEC and the Department of Labor's Employee Benefits Security Administration (regarding those retirement accounts and plans regulated under the Employee Retirement Income Security Act (ERISA) of 1974).
54. Fifteen percent of all U.S. families (as defined in the Federal Reserve's Survey of Consumer Finances) directly hold stock, and 53 percent hold stock in some form (including retirement accounts and mutual funds). See Board of Governors of the Federal Reserve System, "Survey of Consumer Finances, 1989–2019: Directly Held Stocks by All Families," https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:Directly_Held_Stocks;demographic:all;population:1;units:have (accessed June 12, 2021), and Board of Governors of the Federal Reserve System, "Survey of Consumer Finances, 1989–2019: Stock Holdings by All Families," https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:Stock_Holdings;demographic:all;population:1;units:have (accessed June 15, 2021). For the Survey of Consumer Finance's definition of family, see Board of Governors of the Federal Reserve System, "Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, Vol. 106, No. 5 (September 2020), pp. 32 and 33, https://www.federalreserve.gov/publications/files/scf20.pdf (accessed June 14, 2021).

55. The Trump Administration took steps in this regard. See U.S. Department of Labor, Employee Benefits Security Administration, "Financial Factors in Selecting Plan Investments," Final Rule, *Federal Register*, Vol. 85, No. 220, November 13, 2020, https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf (accessed June 12, 2021), and U.S. Department of Labor, Employee Benefits Security Administration, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," Final Rule, *Federal Register*, Vol. 85, No. 242 (December 16, 2020), https://www.govinfo.gov/content/pkg/FR-2020-12-16/pdf/2020-27465.pdf (accessed June 12 2021). The Biden Administration appears to be poised to reverse these steps. U.S. Department of Labor, Employee Benefits Security Administration, "U.S. Department of Labor Statement Regarding Enforcement of Its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans," March 10, 2021, https://aboutblaw.com/WaM (accessed June 12, 2021). ("Until it publishes further guidance, the Department will not enforce either final rule or otherwise pursue enforcement actions against any plan fiduciary based on a failure to comply with those final rules with respect to an investment.")
56. Proxy Preview, "Proxy Preview 2020," p. 66, https://www.proxypreview.org/2020/report-cover (accessed June 12, 2021).
57. In Section 2 of the Securities Act, Congress should define "material" as follows:
    (20) The term "material" means, when used to qualify a requirement for the furnishing of information as to any subject, information limited to those matters regarding which there is a substantial likelihood that a reasonable investor would attach importance when—
    (i) evaluating the potential financial return and financial risks of an existing or prospective investment, or
    (ii) exercising, or declining to exercise, any rights appurtenant to securities.
    The term "material" does not include, when used to qualify a requirement for the furnishing of information as to any subject, information that—
    (i) primarily furthers non-pecuniary, non-economic, or non-financial social or political goals or objectives, or
    (ii) primarily relates to events that—
    (A) involve a high degree of uncertainty regarding what may or may not occur in the distant future, and
    (B) are systemic, general, or not issuer specific in nature.
58. Each of these terms (with the possible exception of the latter two, which are of comparatively recent vintage), has evolved in meaning over time and has substantially—even dramatically—different meanings depending on the author or speaker. There is a voluminous literature discussing—but seldom *defining*—these concepts. In the case of "social justice," the term has changed meaning with the political and social situation for two centuries. In contemporary political parlance, it is associated with ideologies that are, at the very least, deeply suspicious of market outcomes and that countenance a high degree of government intervention in the economy. Often, it is a proxy term for social democratic or socialist views on economics and Critical Race Theory (CRT) views on social issues. Its economic dimension rests on the premise that a pre-determined distribution of goods should be enforced by the state. This is a substantially different conception of justice than most, which rely on evaluating individual actions, merit, and desert. Similarly, CRT evaluates people in terms of their membership in racial, ethnic, or sexual groups rather than as individuals. Advocates rarely actually discuss what social justice is, nor do they define "stakeholder"— most are utterly unable to do so. Even fewer offer suggestions on how boards or management would weigh the claims of competing stakeholders or the implications of these concepts for shareholders and society at large. Social justice and stakeholders are buzzwords or fuzzwords that count as virtue signaling for the writer or speaker. For a selection of recent discussions of these concepts from both perspectives, see Mike Gonzalez, *The Plot to Change America: How Identity Politics is Dividing the Land of the Free* (New York: Encounter Books, 2020); Peter W. Wood, *Diversity Rules* (New York: Encounter Books, 2019); Brian Barry, *Why Social Justice Matters* (Cambridge: Polity Press, 2005); Michael Novak, Paul Adams, and Elizabeth Shaw, *Social Justice Isn't What You Think It Is* (New York: Encounter Books, 2015); David Miller, *Principles of Social Justice*, revised ed. (Cambridge, MA: Harvard University Press, 2001); Thomas Patrick Burke, *The Concept of Justice: Is Social Justice Just?* (New York: Bloomsbury Academic, 2011); and Friedrich A. von Hayek, "The Atavism of Social Justice," in Friedrich A. von Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas*, Chapter 5 (Abingdon-on-Thames: Routledge, 1978). For historical context, see Leonard Trelawny, *The Elements of Social Justice* (London: George Allen & Unwin, 1922), and John Bates Clark, *Social Justice Without Socialism* (Boston: Houghton Mifflin, 1914).
59. The broader social costs associated with ESG requirements can, in principle, be quantified. See the section heading "The Social Welfare Cost of ESG Requirements" in David R. Burton, "Nasdaq's Proposed Board-Diversity Rule Is Immoral and Has No Basis in Economics," Heritage Foundation *Backgrounder* No. 3591, March 9, 2021, https://www.heritage.org/sites/default/files/2021-03/BG3591_0.pdf. See also the section heading "Why Markets 'Work'" in David R. Burton, "Comparing Free Enterprise and Socialism," Heritage Foundation *Special Report* No. 213, April 30, 2019, https://www.heritage.org/sites/default/files/2019-05/SR213.pdf.
60. 12 U.S. Code § 1831a.
61. If the bank sells investments to customers, it will also be subject to regulation by the Financial Industry Regulatory Authority (FINRA).
62. Besides the OCC, the Financial Crimes Enforcement Network and the IRS impose a wide variety of information-reporting and due-diligence requirements on financial institutions. The Treasury's recent request for "Public Input on Expanding Access to Credit Through Online Marketplace Lending" shows that it is clearly contemplating greater regulation of online lenders. U.S. Department of the Treasury, "Public Input on Expanding Access to Credit Through Online Marketplace Lending," Billing Code 4810-25-P, July 17, 2015, https://www.treasury.gov/connect/blog/Documents/RFI%20Online%20Marketplace%20Lending.pdf (accessed June 12, 2012). Separately, Title I of Dodd–Frank created the Financial Stability Oversight Council, a council that consists of the heads of many of the above-mentioned regulatory agencies, and tasked it with several broad responsibilities, such as identifying systemically important financial institutions and activities. See Norbert J. Michel, "The Financial Stability Oversight Council: Helping to Enshrine 'Too Big to Fail,'" Heritage Foundation *Backgrounder* No. 2900, April 1, 2014, http://www.heritage.org/research/reports/2014/04/the-financial-stability-oversight-council-helping-to-enshrine-too-big-to-fail.

63. Credit unions are regulated by the National Credit Union Administration (NCUA), a separate independent federal agency.

64. Supervision and examination authority are complementary, and they cover a wide range of activities. Supervision involves both the initial development and publication of rules to implement statutory law, and fewer formal press releases and circulars known as "guidance." See David R. Burton and Norbert J. Michel, "Financial Institutions: Necessary for Prosperity," Heritage Foundation *Backgrounder* No. 3108, April 14, 2016, https://www.heritage.org/markets-and-finance/report/financial-institutions-necessary-prosperity#:~:text=Financial%20intermediaries%20serve%20a%20key%20role%20in%20the%20U.S.%20economy.&text=In%20return%20for%20providing%20their,pay%20to%20depositors%20or%20creditors. Regulators also use the informal examination process to implement changes, and banks tend to comply with regulators' informal suggestions because failure to do so can bring additional regulatory scrutiny or formal enforcement actions. There is essentially no appeals process for this type of regulation. See Julie Hill, "When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations," *Washington University Law Review*, Vol. 92 (2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2494634## (accessed June 12, 2021).

65. Title VI of Dodd–Frank, Public Law No. 111–203, July 21, 2010, broadened the Fed's holding company authority. See "Title VI: New Authority for the Fed," in Hester Peirce and James Broughel, eds., *Dodd–Frank: What It Does and Why It's Flawed* (Arlington, VA: Mercatus Center at George Mason University, 2012), pp. 66–75.

66. Public Law No. 81–797, 12 U.S. Code § 1811 et seq.

67. 12 U.S. Code § 1813(q).

68. 12 U.S. Code § 1828(c)(2).

69. Michel, "The Financial Stability Oversight Council: Helping to Enshrine 'Too Big to Fail,'" and Peter Wallison, "Title I and the Financial Stability Oversight Council," in Norbert J. Michel, ed., *The Case Against Dodd–Frank: How the 'Consumer Protection' Law Endangers Americans* (Washington, DC: The Heritage Foundation, 2016), https://thf-reports.s3.amazonaws.com/2016/The%20Case%20Against%20Dodd-Frank.pdf.

70. One voting member, the CFTC, has already released its own report on climate change risks and financial regulation. See U.S. Commodity Futures Trading Commission, "Managing Climate Risk in the U.S. Financial System," September 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 (accessed April 30, 2021).

71. 12 U.S. Code § 5322(a)(1)(C).

72. 12 U.S. Code § 1820(d)(1).

73. Federal Deposit Insurance Corporation, "Uniform Financial Institutions Rating System," Notice of Adoption of Policy Statement, *Federal Register*, Vol. 62, No. 3 (January 6, 1997), https://www.fdic.gov/regulations/laws/federal/UFIR.pdf (accessed April 20, 2021). This system was adopted in 1979 by the Federal Financial Institutions Examination Council (FFIEC), an interagency regulatory body that consists of the Federal Reserve Board of Governors, the FDIC, the NCUA, the OCC, and the CFPB. The FFIEC is empowered to prescribe uniform principles, standards, and report forms for federal regulators, with the goal of promoting "consistency in such examination and to insure progressive and vigilant supervision." See Title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, 12 U.S. Code § 3301.

74. Sensitivity to market risk (the "S") was added in 1996. See news release, "Uniform Financial Institutions Rating System," Federal Reserve Board of Governors, December 24, 1996, http://www.federalreserve.gov/BoardDocs/press/general/1996/19961224/default.htm (accessed April 20, 2021).

75. Federal Deposit Insurance Corporation, "Uniform Financial Institutions Rating System," p. 752.

76. The bank has to be in "generally sound financial condition" (12 CFR § 201.4) and generally have a composite CAMELS rating of 1, 2, or 3. See news release, "Interagency Advisory on the Use of the Federal Reserve's Primary Credit Program in Effective Liquidity Management," Board of Governors of the Federal Reserve System, January 9, 2003, p. 2, https://www.federalreserve.gov/boarddocs/press/bcreg/2003/20030723/attachment.pdf (accessed April 20, 2021).

77. According to the Fed's guidance, "Under very limited circumstances, the Federal Reserve may consider proposals from organizations with one or more component ratings of '3' or a composite rating of '3' for safety and soundness." Board of Governors of the Federal Reserve System, Supervision and Regulation Letters, "SR 14-2/CA 14-1: Enhancing Transparency in the Federal Reserve's Applications Process," February 24, 2014, https://www.federalreserve.gov/supervisionreg/srletters/sr1402.htm (accessed April 20, 2021).

78. 12 CFR § 327.16. Separately, a firm cannot qualify for *financial holding company* status (to engage in expanded financial activities beyond banking) unless its subsidiary depository institutions all remain "well-managed," a term that includes a composite CAMELS rating of 1 or 2, and at least a satisfactory rating for management. See 12 U.S. Code § 1843(l) and 12 U.S. Code § 1841(o)(9).

79. For restrictions on brokered deposits, see 12 U.S. Code § 1831f(a); for restrictions on asset-size growth, see 12 U.S. Code § 1831o(e)(3); for restrictions on branching and acquiring new lines of business or other financial firms, see 12 U.S. Code § 1831o(e)(4).

80. 12 CFR § 5.51.

81The International Lending and Supervision Act is actually Title IX of Public Law No. 98–181, 97 Stat., codified at 12 U.S. Code § 3901 et seq.

82. 12 U.S. Code § 3907 and 12 U.S. Code § 1831o(c).

83. 12 U.S. Code § 3907(a)(1).

84. 12 U.S. Code § 3907(b)(1).
85. 12 U.S. Code § 1818.
86. 12 U.S. Code § 3907(a)(2).
87. The Basel III standards are an internationally agreed upon set of measures developed by the Basel Committee on Banking Supervision. See Bank for International Settlements, "Basel III: International Regulatory Framework for Banks," https://www.bis.org/bcbs/basel3.htm (accessed April 21, 2021).
88. 12 CFR § 217.1(d)(3).
89. 12 CFR § 225.8.
90. 12 CFR § 217.1. For FDIC-regulated institutions, risk-weighted capital rules are also based on Basel III. See 12 CFR § 324.10 and 12 CFR § 325.103.
91. 12 U.S. Code § 3907(b)(3)(c).
92. Julie Anderson Hill, "Regulating Bank Reputation Risk," *Georgia Law Review*, Vol. 54 (2020), pp. 543–553, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3353847#:~:text=Regulators%20use%20reputation%20risk%20to,it%20to%20address%20other%20controversies (accessed May 26, 2021).
93. Ibid., p. 545.
94. Ibid., p. 532.
95. Office of the Comptroller of the Currency, *Comptroller's Handbook: Examination Process, Large Bank Supervision*, June 2018, p. 64, https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/large-bank-supervision/index-large-bank-supervision.html (accessed May 26, 2021). The NCUA has a similar definition to the OCC; see ibid., p. 546.
96. Office of the Comptroller of the Currency, *Comptroller's Handbook*, p. 30.
97. Ibid., p. 31.
98. Federal Reserve Board of Governors, Supervision and Regulation letter 95-51 (SUP), November 14, 1995, revised February 26, 2021, https://www.federalreserve.gov/boarddocs/srletters/1995/sr9551.htm (accessed May 26, 2021).
99. Ibid.
100. Federal Deposit Insurance Corporation, "Basic Examination Concepts and Guidelines," in *Risk Management Manual of Examination Policies*, February 2021, p. 25, https://www.fdic.gov/regulations/safety/manual/section1-1.pdf (accessed May 26, 2021).
101. Hill, "Regulating Bank Reputation Risk," p. 532.
102. Federal Deposit Insurance Corporation, Office of the Inspector General, "The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities," Report No. AUD-15-008, September 2015, p. 12, https://www.oversight.gov/report/fdic/fdic%E2%80%99s-role-operation-choke-point-and-supervisory-approach-institutions-conducted (accessed May 26, 2021).
103. News release, "FDIC Issues Examination Guidance for Payday Lending," Federal Deposit Insurance Corporation, July 2, 2003, https://www.fdic.gov/news/press-releases/2003/pr7003.html (accessed April 23, 2021). Also see Federal Deposit Insurance Corporation, "Guidelines for Payday Lending," https://www.fdic.gov/news/press-releases/2003/pr7003a.pdf (accessed May 26, 2021).
104. News release, "FDIC Issues Examination Guidance for Payday Lending," p. 8.
105. Ibid., p. 4.
106. Federal Deposit Insurance Corporation, "Payday Lending Programs: Revised Examination Guidance (Revised November 2015)," Financial Institution Letter No. 14-2005, March 1, 2005, https://www.fdic.gov/news/financial-institution-letters/2005/fil1405.pdf (accessed April 23, 2021).
107. Federal Deposit Insurance Corporation, Office of the Inspector General, "The FDIC's Role in Operation Choke Point," p. 1.
108. Kelsey Bolar, "Unsealed Choke Point Documents Show Obama Was Far From Scandal-Free," The Daily Signal, October 16, 2018, https://www.dailysignal.com/2018/10/16/unsealed-choke-point-documents-show-obama-was-far-from-scandal-free/.
109. Federal Deposit Insurance Corporation, Office of the Inspector General, "The FDIC's Role in Operation Choke Point," pp. 11 and 12.
110. Ibid., pp. 12 and 13.
111. See Board of Governors of the Federal Reserve, SR 13-19 / CA 13-21: Guidance on Managing Outsourcing Risk, December 5, 2013 (revised February 26, 2021), https://www.federalreserve.gov/supervisionreg/srletters/sr1319.htm (accessed April 26, 2021), and Office of the Comptroller of the Currency, OCC Bulletin 2013-29, October 30, 2013, "Third-Party Relationships: Risk Management Guidance," Appendix A, https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html (accessed April 26, 2021).
112. 12 U.S. Code § 1818(a)(2)(A)(i).
113. 12 U.S. Code § 1818(b).
114. 12 U.S. Code § 1818(b)(7).

115. 12 U.S. Code § 84(a)(1). Also see 12 CFR 32.3. This requirement also applies to national savings associations.
116. 12 U.S. Code § 84(a)(2).
117. 12 U.S. Code § 84(d)(1).
118. 12 U.S. Code § 2901, et seq.
119. Diego Zuluaga, "The Community Reinvestment Act in the Age of Fintech and Bank Competition," Cato Institute *Policy Analysis* No. 875, July 10, 2019, https://www.cato.org/sites/cato.org/files/pubs/pdf/pa-857-updated-2.pdf (accessed May 26, 2021).
120. 12 U.S. Code § 2901(b).
121. Griffith L. Garwood and Dolores S. Smith, "The Community Reinvestment Act: Evolution and Current Issues," *Federal Reserve Bulletin*, April 1993, https://fraser.stlouisfed.org/files/docs/publications/FRB/pages/1990-1994/33103_1990-1994.pdf (accessed May 26, 2021), and Kriston Capps, "It's Time to Rewrite Fair Lending Rules. (Just Not Like This.)," Bloomberg, August 31, 2018, https://www.bloomberg.com/news/articles/2018-08-31/the-problem-with-this-community-reinvestment-act-update (accessed May 26, 2021). For the latest CRA final rule, see U.S. Department of the Treasury, Office of the Comptroller of the Currency, "Community Reinvestment Act Regulations," *Federal Register*, Vol. 85, No. 109, June 5, 2020, p. 34734, https://www.govinfo.gov/content/pkg/FR-2020-06-05/pdf/2020-11220.pdf (accessed May 26, 2021). Also see 12 CFR § 228.
122. Michela Zonta and Zoe Willingham, "A CRA to Meet the Challenge of Climate Change," Center for American Progress, December 17, 2020, https://www.americanprogress.org/issues/economy/reports/2020/12/17/493886/cra-meet-challenge-climate-change/ (accessed May 26, 2021).
123. 12 U.S. Code § 5365.
124. See Section 115 of Dodd–Frank, 12 U.S. Code § 5325.
125. 12 U.S. Code § 5365(a)(1).
126. 12 U.S. Code § 5365(a)(1)(A).
127. 12 U.S. Code § 5365(a)(1)(B).
128. 12 U.S. Code § 5365(b)(3)(A)(iii).
129. 12 U.S. Code § 5365(b)(3)(A)(iv).
130. 12 U.S. Code § 5365(b)(3)(C).
131. 12 U.S. Code § 5365(b)(3)(A)(i).
132. The phrase "section 5323 of this title" refers to Section 113 of Dodd–Frank.
133. This authority is commonly referred to as the power to designate firms as "systemically important financial institutions (SIFIs)," even though the law does not actually identify the firms as such. 12 U.S. Code § 5323(a)(1).
134. 12 U.S. Code § 5325(a)(1).
135. 12 U.S. Code § 5325(a)(1).
136. 12 U.S. Code § 5325(a)(2)(A).
137. 12 U.S. Code § 5323(a)(2)(G).
138. 12 U.S. Code § 5323(a)(2)(K).
139. 12 U.S. Code § 5325(b)(1).
140. Federal Reserve Board of Governors, "Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations," Final Rule, *Federal Register*, Vol. 84, No. 212 (November 1, 2019), https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23662.pdf (accessed April 14, 2021).
141. Ibid., p. 59034.
142. Another complicating factor is that this category is measured at the top-tier level of the bank holding company.
143. Federal Reserve Board of Governors, "Prudential Standards for Large Bank Holding Companies," p. 59035. The various stress test and capital requirements are, of course, administered under separate rulemakings.
144. Technically, other factors besides asset size determine the category. For instance, cross-jurisdictional activity and wholesale funding are considered. As with GSIBs, each factor is measured at the top-tier level of the bank holding company. See Federal Reserve Board of Governors, "Prudential Standards for Large Bank Holding Companies," p. 59035.
145. Financial Stability Oversight Council, "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies," Final Interpretive Guidance, *Federal Register*, Vol. 84, No. 249 (December 30, 2019), p. 71741, https://home.treasury.gov/system/files/261/Authority-to-Require-Supervision-and-Regulation-of-Certain-Nonbank-Financial-Companies.pdf (accessed April 14, 2021).
146. Financial Stability Oversight Council, "Authority to Require Supervision," p. 71742.

147. If the agency is not expected to perform the analysis, the FSOC will perform its own prior to making a recommendation, and only make a recommendation if "it believes that the results of its assessment of benefits and costs support the recommendation." Ibid., p. 71742.
148. Financial Stability Oversight Council, "Authority to Require Supervision," p. 71744.
149. Ibid.
150. Ibid.
151. 12 U.S. Code § 5323.
152. 12 U.S. Code § 5323(a)(1).
153. 12 U.S. Code § 5330(a).
154. 12 U.S. Code § 5325.
155. 12 U.S. Code § 5325(b)(1).
156. See footnote 56 for potential statutory language.
157. Most important, the SEC and the Department of Labor's Employee Benefits Security Administration (regarding those retirement accounts and plans regulated under ERISA of 1974).
158. See Norbert J. Michel, "Money and Banking Provisions in the Financial CHOICE Act: A Major Step in the Right Direction," Heritage Foundation *Backgrounder* No. 3152, August 31, 2016, https://www.heritage.org/markets-and-finance/report/money-and-banking-provisions-the-financial-choice-act-major-step-the, and Norbert J. Michel, ed., *Prosperity Unleashed: Smarter Financial Regulation* (Washington, DC: The Heritage Foundation, 2017), https://thf-reports.s3.amazonaws.com/2017/ProsperityUnleashed.pdf.