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Partisan battle brewing over regulators' ESG focus

Neil Haggerty

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For months, regulators and Democratic policymakers have shined a brighter spotlight on social disparities in the financial system and banks' climate-change risks. But GOP objections to that focus are also getting louder.

Senate Banking Committee Chairman Sherrod Brown, D-Ohio, has led an examination by the panel into the racial wealth gap just as the Federal Reserve studies similar issues and weighs climate stress tests for banks. On Tuesday, Treasury Secretary Janet Yellen suggested financial institutions should structure their businesses around the Paris Agreement on climate change.

But Republicans in both the House and Senate have opened a new line of attack in response, saying that the financial system is an inappropriate arena for addressing social and climate issues.

"By straying from its core mission and authorities in support of vague and ill-defined climate goals, the Federal Reserve’s actions threaten to undermine its credibility and betray its independence," said Sen. Pat Toomey of Pennsylvania, the top Republican on the Senate Banking Committee, at a March 18 hearing.

Republicans' counterpunch is centered on the idea that they don’t see a role for banks and their regulators to conduct social policy.

“Republicans don't think financial services providers should be used as tools to advance public policy objectives, saying it's just not appropriate, it's not their role, they should be focused on generating a profit and returns for their investors, not on a social justice agenda," said Dan Crowley, a partner at K&L Gates. "Republicans don't view climate change as within the regulatory responsibilities of the federal agencies. They see financial regulation and climate change as apples and oranges.”

Toomey has called out the Financial Stability Oversight Council for prioritizing the risks associated with climate change. Last week, he criticized research by the Federal Reserve Bank of San Francisco that examines environment, social and governance policies. Toomey referred to such research by the Fed regional banks as "mission creep."

After Yellen remarked at last week's FSOC meeting that climate change was an "existential threat," Toomey said the new Democratic policy priority "is not grounded in science or economics, but is instead a self-fulfilling prophecy: claim there are future regulatory risks for carbon intensive industries, then use unelected, unaccountable financial regulators to impose regulatory costs on those activities."

“If Congress believes current environmental policies do not adequately address climate-related risks, changes should be enacted through the legislative process — not through financial regulation," he said.

Democrats are also planning to hold hearings with the CEOs of JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs and Morgan Stanley in the upcoming months about their efforts to address COVID-19, climate change and racial equity, according to a Politico report.

To some extent, Democrats in Congress and the Biden administration have followed actions by banks on social issues. During the Trump administration, several large banks took high-profile positions curtailing some lending activity with the firearms and fossil fuel industry, which outraged Republicans. Brian Brooks, then the acting comptroller of the currency, advanced a rule that would prohibit banks from limiting business to disfavored sectors, yet publication of the rule was halted after President Biden took office.

Among the recent actions by the industry, Bank of America recently expanded its racial equity pledge to include Asian Americans. Mastercard announced last month that it is linking its bonus payments to executives to how they contributed to progress on efforts to curb the firm’s use of carbon, improve financial inclusion and reach gender-pay parity. Wells Fargo has pledged to achieve net-zero greenhouse gas emissions by 2050.

But Republicans have pushed for legislation that would prohibit banks from discriminating against businesses out of fear that regulators are taking a position in politically divisive issues.

“Banking isn’t a red-versus-blue battleground. Law-abiding Americans should have access to financial services regardless of political position,” Sen. John Kennedy, R-La., also a member of the Banking Committee, said in a March press release. “The Fair Access to Banking Act would ensure that banks rely on impartial risk assessments — rather than politicized discrimination — when providing their services. If banks want to become advocacy groups that ignore the Constitutional protections of their clients, they would be breaking the law."

Rep. Andy Barr, R-Ky., who introduced the House version of the Fair Access to Banking Act, said the bill would codify an Office of the Comptroller of the Currency rule issued under Brooks.

“Banks should make lending decisions relying on objective, risk-based metrics, not the standards of woke corporate cancel culture,” Barr said in a March press release.

Analysts say the fundamental disagreement between the two parties is over the purpose of the banking system.

“That's really the heart of the debate, which is: What are banks for?” said Karen Petrou, managing partner at Federal Financial Analytics. “Are they essentially lending utilities that must lend unless a regulator deems it too risky based on a traditional credit risk metric? Or are they allowed to make their own decisions about risk and incorporate social welfare factors when they do so?”

Jeremy Kress, a former financial regulation attorney at the Federal Reserve and now an assistant professor of business law at the University of Michigan, said the banking system is inherently tied to government.

“For years, the debate over banking policy has been over what we do not want our banks to be doing — proprietary trading, leveraged lending, swaps dealing,” said Kress. “What you're seeing now is that the debate is shifting to what do we affirmatively want our banks to be doing: How can the banks best serve society? I think these political debates reflect the fact that banks are not purely private businesses. Rather, they're quasi-governmental entities that create money as an extension of the state.”

But Jennifer Schulp, director of financial regulation studies at the Cato Institute’s center for monetary and financial alternatives center, argued that the GOP criticism rightly stems from concerns about government agencies stepping outside their traditional roles.

“I think the Republicans are more focused here on maintaining a bit more of the difference between the individual agencies’ mandate, which I think is the right move,” Schulp said. “I don't think the SEC or the OCC are a good place to make environmental policy. We have environmental agencies for that.”

Besides the San Francisco Fed's research, the Federal Reserve Bank of New York published a paper in January on monetary policy and racial inequality. And in 2019, the Federal Reserve Bank of Boston’s New England Center for Public Policy published a report on the causes and responses to the opioid epidemic.

Petrou said the Fed’s wide-ranging research has been a cornerstone of the central bank's work.

“The Fed’s research agenda has always been extraordinarily broad,” Petrou said. “There’s just not that much monetary policy for all of [the Fed’s researchers] to study. … Sen. Toomey’s complaint, if it continues, is directed not only at the San Francisco Fed, but really at a tradition of the Fed in terms of its research agenda.”

While Republicans argue that financial regulators step out of their lane when they trying to address climate change or promote diversity policies, Democrats have long argued that such issues are directly connected to oversight of the financial system.

“The initiatives that I think we've seen ... are more about reducing risk in the banking system by addressing climate risks within the financial system,” Kress said. “So that to me is ... not as closely tied to achieving a social policy objective that is unconnected to banking. It's squarely within the financial regulators’ mandate.”

Schulp said the industry can expect the partisan debate about its role in addressing climate change and social policies to continue.

“Many on the progressive side of the aisle have made it intentionally an aim of financial regulation to wade into areas that financial regulation is typically not concerned with, climate change and social policies as two examples," she said. “And I think we're going to be in for a lot of long and very difficult conversations about this, because it's dragging financial regulation into a space where it's not the jobs of the financial regulators to make that type of policy.”