September 18, 2023

The Honorable Janet Yellen
Chair
Financial Stability Oversight Council
1500 Pennsylvania Avenue
NW, Room 2308, Washington, DC 20220

Dear Secretary Yellen:

We are writing 15 years after the 2008 financial crisis began to urge the Financial Stability Oversight Council (FSOC) to fulfill its mission on climate-related financial risk. In response to the 2008 financial crisis, Congress created FSOC to identify and mitigate threats to financial stability. To date, climate-related impacts and risks to financial stability are far outpacing FSOC and its members' responses. FSOC must quickly do more to address the rapidly growing systemic financial risks related to climate change.

As frequent news reports detail, physical risks are materializing more quickly and significantly than many imagined. The National Oceanic and AtmosphericAdministration (NOAA) just confirmed that the U.S. has set a record for the most natural disasters in a single year that have cost $1 billion or more. The record-breaking 23 events in 2023 have occurred with four months remaining in the year.

Climate change is turbocharging fires, floods, heat and hurricanes, and in the process threatening homes, other physical structures, agriculture, water supplies, and other public goods and services. It is increasing disease, migration, conflict, and political instability. And unlike other financial risks, many climate-related physical changes are effectively irreversible. Scientists warn that permanent and devastating physical tipping points may already be triggered at our current level of warming.

Costs of climate-related impacts are already unprecedented—and staggering. The 2023 disasters noted above caused $57.6 billion in losses, not including costs related to tropical storm Hilary. Insurance companies are significantly raising premiums and withdrawing from high-risk markets, citing climate-related disasters. Consumers in Florida, California, Louisiana, Texas, Colorado and other states face soaring premiums—or the prospect of having no property and casualty insurance at all. Unlike FSOC, state insurance regulators lack the capacity or jurisdiction to identify and address the national and global financial stability risks posed by these developments.

Researchers are identifying the many obvious and less readily apparent ways these physical impacts are threatening the financial system. As one Federal Reserve Board staff report describes, climate risk would flow from insurers to consumers when insurer capacity is exceeded, then on to lenders and municipalities when individuals cannot pay their bills and taxes. Ultimately, these scenarios see the costs flow to communities and taxpayers more generally when lenders and municipalities can no longer absorb financial losses.

Severe risks for lenders are growing, for example, in areas facing worsening concentrated flood risks, where single-family residential properties are estimated to be overvalued by at least $520 billion. Approximately 3.5 million to 4.2 million homeowners are exposed to major repricing, and mortgage defaults could increase by as much as 40%. And these figures include only unpriced flood risk, not other climate-related risks. Homeowners will lose value in their largest assets—their homes—while municipalities will lose tax revenue and face budgetary shortfalls at the same time as they face higher costs for infrastructure repair and maintenance; adaptation, resilience, and recovery measures; and rising demand for services. Such impacts to housing and to municipal budgets could threaten our economy and financial stability.

The transition from fossil fuels to renewable energy is also occurring more quickly than many anticipated. Some researchers suspect that transition-related tipping points have already been passed, with severe consequences for industries that are failing to take the shift seriously. One analysis suggests that $2.1 trillion in assets in the global electric-power sector alone could be stranded by 2050, noting that this reality is becoming more certain as the transition continues to gain speed. Other research indicates that half of the world's fossil fuel assets—$11 trillion to $14 trillion worth—could become worthless by 2036 under a net-zero transition.

Remarkably, despite these increasing transition risks, fossil fuel financing and underwriting are still not significantly declining.

You recently sounded the alarm on climate risks, saying it is "imperative" that we "take decisive action to fight climate change" for both the planet and "the global economy." FSOC, for its part, has labeled climate-related risk an emerging and increasing threat to U.S. financial stability.

Against this backdrop, FSOC has begun to build capacity and identify climate-related risks, but has taken no concrete or specific steps to mitigate them. And according to its recent progress report, it does not plan to do much more on the short timeline needed to get ahead of the risk. Its proposed guidance for designating systemically important non-bank financial companies and its proposed analytic framework for financial stability risk are important first steps. But FSOC's articulated follow-up plans are merely to collect more data, better assess risks, and enhance coordination. These measures are painfully inadequate in the face of how quickly the crisis is developing. None will actually mitigate climate-related risk. None will prevent a climate-related financial crisis from wrecking the financial system and broader economy while doing untold damage to U.S. families.

Congress created FSOC to prevent crises proactively—not merely to write reports noting the need to study the possibility that they may occur or, when crises hit, watch as FSOC members attempt to rescue the financial system with extraordinary measures. These rescue efforts may not always succeed. And even when they do, they deepen the types of moral hazard and structural instabilities in the financial system that Congress sought to remedy with the Dodd-Frank Act. Congress vested FSOC with powerful authorities to mitigate systemic risk, and the Council could serve as one of the most important leaders globally on identifying risks and recommending solutions. It is well past time for FSOC to fulfill its mission and apply these endowments to mitigating climate-related financial risks.

FSOC and its members must act urgently to mitigate climate-related financial risk, not merely study it. We urge you to pursue the following measures:

- Quickly finalize FSOC's proposed guidance and analytic framework and designate non-bank financial companies, particularly major insurers, private equity firms, and asset managers, for enhanced federal supervision. If a large, significant firm contributes substantially to climate-related financial risk or its drivers, has demonstrated an inability to manage it properly, or is harming consumers through its actions in response to climate change, these factors should weigh heavily in favor of designation and enhanced supervision.
- In response to insurance industry turmoil that state regulators and budgets lack the capacity to manage, recommend to Congress that it create a federal reinsurance backstop to protect consumers, incentivize risk mitigation measures, and stabilize markets—one that provides basic consumer protections; includes a just, equitable plan to amply support relocation where it is needed and desired; and requires insurers, as a condition of access, to phase out their support for fossil fuels in excess of science-based climate targets.
- Endorse a precautionary approach in response to the radical uncertainty of climate-related financial risks, recognizing that they could cause unacceptably high losses for the financial system and the economy and must, therefore, be proactively mitigated, even in the absence of certain forms of data, modeling, or analysis.
- Recommend to FSOC members actions commensurate with the severity of climate-related financial risks, such as the following:
    - Immediately and continuously collect data on racial and economic disparities in access to financial services within their remit, vigorously monitor potential and actual fair lending violations, and develop consumer protections to head off abuses that may result from supervised institutions' climate risk management strategies as well as new climate-related consumer financial products.
    - Finalize the draft supervisory principles on climate-related risk for large banks, and quickly follow up with more specific, enforceable guidelines on major components of the principles.

- Finalize the proposed update to the Community Reinvestment Act regulations that explicitly classifies equitable and safe climate investment as an eligible activity and that better targets these investments to climate-vulnerable communities.
- Direct financial institutions under their supervision to incorporate climate-related risk into their own capital adequacy assessments and stress testing and, as the Basel Committee on Banking Supervision has suggested, incorporate a margin of conservatism when evaluating climate-related risks and asset quality.
- Require an ample margin of safety when assessing the quality of assets that contribute to or could be exposed to climate-related financial risk, and establish capital rules that address their riskiness.
- Incorporate climate-related risks into the Comprehensive Capital Analysis and Review.
- Direct large financial institutions under their supervision to create and implement credible science-aligned transition plans that include clear metrics and interim targets and do not rely on offsets; and require the institutions to disclose elements of the plans and provide progress reports sufficient for investors, customers, and regulators to assess their compliance.
- Incorporate climate risk disclosures—including around assets exposed to physical risk and fossil fuel assets—into bank call reports to better inform customers, counterparties, investors, and the public.
- Incorporate climate risk into CAMELS ratings and the Large Financial Institution Rating System.
- Conduct climate-related scenario analysis to test solvency and risks to the Deposit Insurance Fund and the Share Insurance Fund, and consider what if any changes to capitalization or risk premia are needed to ensure ongoing solvency.

Thank you for your time and consideration.

Sincerely,

Public Citizen

Americans for Financial Reform

Sierra Club