November 2, 2023

The Honorable Janet Yellen
Secretary, U.S. Department of the Treasury
Chair, Financial Stability Oversight Council
1500 Pennsylvania Avenue, N.W.
Room 2308
Washington, D.C. 20220

Dear Secretary Yellen:

The undersigned organizations write to express our strong concern about the Financial Stability Oversight Council's response to potentially destabilizing developments in the insurance markets and to recommend action the Council can take to address this unfolding crisis. For decades, the insurance industry has been warned that damages from climate change will cause major stress for their business.[1] Insurers have also been warned that their financing and underwriting of the fossil fuel industry is central to generating and exacerbating these climate-related financial stability risks and that insurers are exposing themselves to transition risks that could manifest in the form of unexpected impairments and defaults.[2]

Without a proactive response from the industry to these emerging risks or meaningful, coordinated action from state and federal regulators, we are now faced with rapidly growing dysfunction in many state insurance markets.[3] While challenges in coastal states have received the most attention, experts have testified to Congress that climate-related risk is reducing the accessibility and affordability of insurance coverage throughout the country, including in a number of inland states.[4]

Identifying and managing threats to the financial system, including the "emerging and increasing threat" posed by climate change, is central to the mission of the Financial Stability Oversight Council (FSOC).[5] Insurers are a "key channel through which climate risk can threaten broader

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[1] *Munich Re*, "Climate Change and its Consequences."
[2] *United States Senate Committee on Banking, Housing, and Urban Affairs*, Letters to Insurance Companies, (June 2023); *Federal Insurance Office*, "Insurance Supervision and Regulation of Climate-Related Risks," (June 2023); See also Remarks by Secretary of the Treasury Janet L.Yellen in New York on Treasury's Principles for Net-Zero Financing & Investment, where you noted recently with respect to climate change "…as impacts on our lives and economies mount, the risks and opportunities increase," and "Vulnerable populations are disproportionately affected because of where they live and the industries in which they work, and low income Americans are no exception." (Sept 2023).
[3] *Wall Street Journal*, "Wildfires and Thunderstorms Are Throwing Insurance Markets Into Turbulence," (August 2023).
[4] *United States Senate Committee on Banking, Housing, and Urban Affairs*, "Testimony of Douglas Heller." (September 2023).
[5] *Department of the Treasury*, "Financial Stability Oversight Identified Climate Change as an Emerging and Increasing Threat to Financial Stability," (October 2021); 12 U.S.C. § 5322(a).

financial stability," as emphasized in a recent staff report by the Federal Reserve Bank of New York.[6] The FSOC's Risk Assessment Working Group has concluded that "insurers and reinsurers are closely interconnected with other financial institutions, including banking institutions, mortgage lenders, and other capital market participants such as asset managers and alternative investment vehicles."[7] It is therefore laudable that the Federal Insurance Office (FIO) - a non-voting FSOC member - has taken numerous steps through data calls and reports to better understand and quantify insurers' exposure to climate-related financial risk.[8]

Recommended actions the FSOC can take to address climate-related financial risks in insurance markets

As climate change-induced disasters continue to affect insurers' ability to perform their risk-bearing function, the FSOC has a responsibility to monitor and address these potential threats to financial stability.[9] In fact, the need for a coordinated response to emerging market crises such as this one is precisely why the FSOC exists.[10] Accordingly, we urge the FSOC to ramp up its response to the unfolding insurance market crisis and consider the applicability of many of the risk-reducing tools at the Council's disposal. Among other possible actions, we call on the FSOC to:

- Swiftly finalize the FSOC's proposed analytic framework and nonbank designation guidance.
- Use the newly finalized analytic framework and guidance to anticipate and manage the insurance sector's exposure to climate-related financial stability threats, including through designation of insurers deemed systemically important.
- Expedite the analytical work on the impact of climate change on household finances and insurance affordability and availability as referenced in your September 2023 remarks in New York on Treasury's Principles for Net-Zero Financing & Investment.[11]
- Respond to emerging threats to financial stability posed by the growing "insurance gap," promoting measures that build the capacities of financial institutions, municipalities and consumers—particularly in LMI and BIPOC communities— to manage climate risks, and that ensure a just allocation of risks and related costs.
- Scrupulously monitor trends in insurance markets through rigorous data collection, and seek to minimize market disruption by fostering collaboration between insurance

[6] *Federal Reserve Bank of New York*, "Measuring the Climate Risk Exposure of Insurers," (July 2023).
[7] *Financial Stability Oversight Council*, "Climate-related financial risks: 2023 Progress Report," (July 2023).
[8] *Federal Insurance Office*, "Insurance Supervision and Regulation of Climate-Related Risks," (June 2023); *Federal Insurance Office*, "Request for Information on the Insurance Sector and Climate-Related Financial Risks," (August 2021).
[9] 12 U.S.C. § 5322(a).
[10] Ibid.
[11] *Janet Yellen*, "Remarks by Secretary of the Treasury Janet L. Yellen in New York, New York on Treasury's Principles for Net-Zero Financing & Investment," (September 2023).

companies and federal and state regulators. This data should be shared publicly to the greatest extent possible.
- Encourage and work with state policymakers to act swiftly on the recommendations made by FIO for integrating climate risk into insurance supervision.[12] Where necessary, provide resources and collaborative tools to state insurance offices that lack the bandwidth to appropriately weigh the financial stability threats posed by insurers and their parent companies.

Climate risks affecting the insurance industry and threats to financial stability

Climate risk in the insurance industry can affect financial stability in several key ways. The first and most direct channel can occur when losses from climate disasters are passed on from insurers to other financial intermediaries. This threat is increasing as insured losses grow.[13] Swiss Re estimates that insured losses exceeded $120 billion in just the first six months of 2023, 46% higher than the 10-year average.[14] This threat is also reflected in the 39 million properties that are underinsured.[15] In response, insurers fail, depart from climate vulnerable areas, and/or hike premiums to rates that are unaffordable.

In recent months, you have rightly warned about this insurance "protection gap," noting that only 60% of $165 billion in damages from 2020's climate disasters were covered by insurance policies.[16] The FSOC's 2022 annual report devoted substantial attention to describing this "protection gap," warning that uninsured losses "have the potential to spill over to other parts of the financial system and real economy."[17]

Indeed, Federal Reserve staff have detailed how these gaps in coverage will impact consumers, mortgage originators, municipalities and other financial market participants. And we are already witnessing profound and growing impacts to consumers in climate-vulnerable areas—particularly to communities that are more vulnerable to these impacts after decades of redlining practices that have left them more exposed to these impacts and with less capacity to respond to them. Research is demonstrating ways that climate change, as well as current climate policy, are heightening inequalities.[18]

The implications for financial stability are profound, as insurers are interconnected to other sectors of the financial system in many ways. In its October Financial Stability Report, the Federal

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[12] *Federal Insurance Office*, "Insurance Supervision and Regulation of Climate-Related Risks," (June 2023).
[13] *Swiss Re*, "Continued high losses from natural catastrophes in 2022," (March 2023).
[14] *Swiss Re*, "Severe thunderstorms account for 70% of all insured natural catastrophe losses," (August 2023).
[15] *Nature Climate Change*," Unpriced climate risk and the potential consequences of overvaluation in US housing markets," (February 2023).
[16] *Bloomberg*, "Janet Yellen Sees a 'Protection Gap' Between Insurance and Climate Change," (July 2023).
[17] *Financial Stability Oversight Council*, "Annual Report," (December 2022).
[18] *Federal Reserve Bank of New York*, "Understanding the Linkages between Climate Change and Inequality in the United States" (November 2021). Federal Deposit Insurance Corporation, "Severe Weather Events and Local Economic and Banking Conditions" (June 2022).

Reserve notes that lending to nonbanks, such as insurers, remained high. As climate-induced disasters fuel insurer failures, banks may be exposed to credit risks from insurers' inability to pay back their obligations.[19]

Another major channel for transmission of insurers' climate risk, which is often referred to as the "asset liquidation" channel, is tied to sales of significant asset holdings to generate liquidity needed to fund payouts.[20] Insurers are important players in U.S. capital markets, investing premiums they hold to cover liabilities and hedge risk.[21] Insurers' ability to use these investments to sustain payouts is becoming more challenged as losses increase and reinsurers pull back in response to climate change. When insurer capacity is threatened, two possible outcomes pose challenges for the financial system. First, these threats could trigger a "fire sale" of insurer investments in U.S. capital markets, placing sudden and steep downward pressure on a range of asset prices throughout financial markets. Second, insurers could fail, in turn triggering losses for a host of financial counterparties. At the end of 2022, a record was set for insurance company insolvencies across a 17-month period.[22]

Other climate-related risks are impacting the insurance sector. For example, FIO's preliminary Paris Aligned Capital Transition Assessment (PACTA) has found substantial transition risks, estimating that the "current exposure of this segment of insurers' investment portfolios to PACTA Scope sectors is approximately $439 billion, or 15% of the $2.9 trillion analyzed."[23] FIO's report also enumerates a sharply rising trend of climate-related litigation and liability risks.[24]

More support and leadership from FSOC needed for state insurance regulators

Major questions exist about whether state insurance regulators are properly evaluating insurers' preparedness for events that might trigger fire sales. Reporting in the *Tampa Bay Times* and *Washington Post* shows a clear pattern of shoddy analysis and lax regulation by the Florida Office of Insurance Regulation, which reportedly skipped a required financial condition exam prior to one insurer going bankrupt.[25] The case also underscores the significant gaps in climate-related insurance supervision identified earlier this year by FIO.[26]

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[19] *Board of Governors of the Federal Reserve System*, "Financial Stability Report," (October 2023).
[20] *International Association of Insurance Supervisors*, "Global Insurance Market Report," (September 2021).
[21] U.S. Treasury recently emphasized the importance of the role of financial institutions, such as insurance companies, to both mobilize more "private sector capital to address the physical and economic impacts of climate change and seize on the historic opportunity presented by the green transition," in its' September 2023, Principles for Net-Zero Financing & Investment. The insurance industry's continued commitment to underwriting and insuring fossil fuels, at the same time that climate change impacts are increasing dysfunction in homeowners' insurance markets, heightens their transition risks. U.S. Treasury's guidance is consistent with leading global approaches such as the U.K. Transition Plan Task Force.
[22] *Bloomberg Law*, "Storm Driven Insurer Insolvencies Stir State Action," (December 2022).
[23] Ibid.
[24] Ibid.
[25] *Tampa Bay Times*, "Florida report on insurance failure raises more questions than answers," (August 2023) and *Washington Post*, "Florida intensifies oversight of insurers after they cut disaster estimates," (May 2023).
[26] Federal Insurance Office, "Insurance Supervision and Regulation of Climate-Related Risks," (June 2023).

State insurance regulators must play a role in protecting against climate-related financial stability threats within the insurance industry. As the insurance industry's impact on the financial system grows, however, there are serious reasons to doubt that state insurance offices have the capacity, expertise, and resources needed to rise to the challenge. For instance, one analysis found that "approximately forty states have no more than three actuaries on staff to review rate filings."[27] After the FSOC voted to remove Prudential's designation as a systemically important financial institution (SIFI) in 2018, one financial stability expert called into question whether the New Jersey Department of Banking and Insurance had sufficient legal authority to regulate the whole range of Prudential's activity at the parent holding company level.[28]

At a minimum, state regulators must take significantly more action than they have to date, or insurers' management of climate risks will remain woefully inadequate. For example, a review of climate risk disclosure survey data showed that only a small minority of insurers are currently conducting scenario analysis on their portfolios, notwithstanding FIO's recommendation that scenario analysis be integrated into state insurance regulation.[29] We urge the FSOC and member agencies to encourage and work with state policymakers to act swiftly on the recommendations FIO made for integrating climate risk into insurance supervision.[30]

Conclusion

One of the major lessons from the 2008 financial crisis was that regulators needed to understand the whole picture of large financial institutions' activities, since the complexity of firms' trading activities across subsidiaries and in various opaque markets had contributed to the crisis.[31] Another major lesson was the need for better coordination between the existing patchwork of federal and state regulators.[32] Congress created the FSOC in the aftermath of that crisis to ensure that a single regulatory body would be accountable to ensuring financial stability as our economy evolves with different and emerging threats.[33] The FSOC was also intended to facilitate greater interagency cooperation than had existed before 2008.[34]

We urge FSOC to exercise this authority, and to serve its core purpose of coordinating many different governmental actors' approaches to addressing the systemic risk of climate change in the

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[27] Daniel Schwarcz, *DePaul Law Review*, "Towards a Civil Rights Approach to Insurance Anti-Discrimination Law," (Winter 2020).
[28] Jeremy C. Kress, *Stanford Law Review*, "The Last SIFI: The Unwise and Illegal Deregulation of Prudential Financial," (December 2018).
[29] Ceres, *Detailed Analysis of 15 Companies*, (July 2023).
[30] Federal Insurance Office, "Insurance Supervision and Regulation of Climate-Related Risks," (June 2023).
[31] *Financial Crisis Inquiry Commission*, "Conclusions of the Financial Crisis Inquiry Commission," (January 2011).
[32] Ibid.
[33] Graham Steele, *Cornell Journal of Law and Public Policy*, "Confronting the Climate Lehman Moment," (February 2020).
[34] See, e.g., 12 U.S.C. § 5322(a)(2)(E).

insurance sector. Among other actions, we call upon the FSOC to swiftly finalize the proposed analytical framework and nonbank designation guidance and to begin using these tools to anticipate and manage the insurance sector's exposure to climate-related financial stability threats, including through designation of insurers deemed systemically important.

In addition, we call upon the FSOC to prioritize and respond to the growing "insurance gap" by promoting measures that build capacity, particularly in LMI and BIPOC communities to manage climate risk and that ensure a just allocation of risks and related costs. Finally, we ask that the FSOC encourage and work with state regulators and policymakers to act swiftly on the recommendations made by the FIO for integrating climate risk into insurance supervision.[35] In order to aid state regulators and policymakers in this effort, FSOC must scrupulously monitor trends in insurance markets through rigorous data collection, and seek to minimize market disruption by fostering collaboration between insurance companies and federal and state regulators.

Sincerely,

350 Colorado
American for Financial Reform Education Fund
CESOSS
Climate Reality Project
ClimateVoice, a project of Tides Center
Connecticut Citizen Action Group
Consumer Federation of America
E3G
Earth Action, Inc.
Earth Ethics, Inc.
Elders Climate Action
Micah Six Eight Mission
Natural Resources Defense Council (NRDC)
Positive Money US
Public Citizen
Rainforest Action Network
Regenerating Paradise
Revolving Door Project
Rise Economy (formerly California Reinvestment Coalition)
Sonoma County Climate Activist Network (SoCoCAN!)
Stand.Earth
Sierra Club

[35] *Federal Insurance Office*, "Insurance Supervision and Regulation of Climate-Related Risks," (June 2023).

Sunrise Project
Third Act
Third Act Connecticut
Urgewald

cc: The Honorable Jerome Powell, Chair, Board of Governors of the Federal Reserve System
The Honorable Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation
The Honorable Gary Gensler, Chair, Securities and Exchange Commission
The Honorable Rostin Behnam, Chairman, Commodity Futures Trading Commission
The Honorable Rohit Chopra, Director, Consumer Financial Protection Bureau
The Honorable Sandra L. Thompson, Director, Federal Housing Finance Agency
Mr. Michael J. Hsu, Acting Comptroller of the Currency, Office of the Comptroller of the Currency
The Honorable Todd Harper, Chairman, National Credit Union Administration
Mr. Thomas E. Workman, Independent Member with Insurance Expertise
Mr. James Martin, Acting Director, Office of Financial Research (OFR), Department of the Treasury
Mr. Steven Seitz, Director, Federal Insurance Office (FIO), Department of the Treasury
Ms. Adrienne Harris, Superintendent, New York State Department of Financial Services
Ms. Elizabeth K. Dwyer, Superintendent of Financial Services, Rhode Island Department of Business Regulation
Ms. Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division