July 27, 2023

Financial Stability Oversight Council
Attention: Mr. Eric Froman
1500 Pennsylvania Avenue, NW, Room 2308
Washington, DC 20220

Dear Mr. Froman,

Americans for Financial Reform Education Fund ("AFREF or "we") greatly appreciates the opportunity to comment on the Financial Services Oversight Council's ("Council") proposed **Analytic Framework for Financial Stability Risk Identification, Assessment and Response (12 CFR Part 1310),** released on April 21, 2023. This was issued together with the proposed Interpretive Guidance on the Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, for which AFR has submitted a separate comment letter.

The proposed Analytic Framework, combined with the Interpretive Guidance, is urgently needed to repeal the 2019 FSOC guidance and restore the FSOC's ability to execute its financial stability responsibilities through the systemic risk regulation of nonbanks. According to Title 1 of the Dodd-Frank Act, the FSOC is responsible for identifying risks to financial stability, promoting market discipline, and responding to emerging threats to the stability of the U.S. financial system.

Low-Income, Minority, or Underserved Communities

AFREF urges the Council use its statutory authority to recommend to the relevant banking agencies, under Section 120 of the Dodd Frank Act, the application of heightened standards or safeguards to protect low-income, minority, or underserved communities, in addition to financial companies and the U.S. financial markets, from the negative impacts of financial contagion.

Lack of Transparency into Growing Nonbank Risk

With "shadow banking" assets of over $20 trillion surpassing bank assets[1], there is a greater need than ever to evaluate the risks posed by nonbanks. The failure to recognize serious risks in the lead-up to the series of mid-sized bank failures in 2023 further underscores the need for a comprehensive and precautionary approach to identifying and responding to nonbank risks. The

[1] Private Fund Statistics, SEC, 3Q 2023

Council is urged to promptly assess the largest, highest risk profile nonbanks for their systemic importance.

Analytic Assessment of Climate Change

Climate change is increasingly recognized as a threat to financial stability, and the framework rightly includes climate-related financial risk (CRFR) in Section II as an area for Council risk monitoring. CRFR shares many of the same risk attributes as the other potential risks outlined in the framework. This includes, for example, concentrated and off-balance sheet risk; interconnections between firms, potentially amplified by overlapping portfolios and vulnerabilities; operational risk; and inadequate disclosure and risk management.[2]

Thank you for the opportunity to comment on the proposed Analytic Framework and respond to the questions for comment below. We believe the proposed Analytic Framework along with the proposed Interpretive Guidance, are urgently needed to protect the financial system and the American public from remaining fall-out of the 2023 banking crisis and prevent future financial crises and bailouts of systemically important financial institutions (SIFIs).

Sincerely

Americans for Financial Reform Education Fund

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[2] https://www.esrb.europa.eu/pub/pdf/reports/esrb.ecb.climate_report202207~622b791878.en.pdf

Appendix

Responses to Questions on the Analytic Framework for Financial Stability Risk Identification, Assessment, and Response

Questions for Comment

1. Will the Proposed Analytic Framework enable the Council to achieve its statutory purposes and perform its statutory duties? Should the Proposed Analytic Framework address additional topics? Are there topics the Proposed Analytic Framework addresses but should not?

Yes. The Analytic Framework will enable the Council to achieve its statutory purposes and perform its statutory duties. AFREF does not believe the proposed framework should address additional topics, and does not believe there are topics addressed by the proposed framework that should not have been.

2. The Proposed Analytic Framework states that financial stability can be defined as the financial system being resilient to events or conditions that could impair its ability to support economic activity, such by intermediating financial transactions, facilitating payments, allocating resources, and managing risks. Are there other definitions of ''financial stability'' the Council should consider?

AFREF agrees with the definition put forward in the Framework proposal and does not recommend other definitions of "financial stability" for consideration.

3. The Council's monitoring for potential risks to financial stability may cover an expansive range of asset classes, institutions, and activities, some of which are noted in the Proposed Analytic Framework. Are there asset classes, institutions, and activities not listed in the Proposed Analytic Framework the Council should monitor for potential risks to financial stability?

The physical impacts of climate change and risk management measures taken by insurers and lenders (e.g., "blue-lining") are increasing the risk of significant liquidity, credit and other financial challenges in low-income, minority and underserved communities.[3] Simultaneously, financial firms are driving the growth of physical climate risk through their significant ongoing financing and insuring of carbon-intensive industry,[4] and transition risks are increasingly concentrated in under-regulated entities.[5] As a consequence of these trends, the Council would be well served to monitor 1) blue-lining practices from insurers, banks, and other entities which disproportionately harm underserved communities, 2) financed emissions which exacerbate climate risk, and 3) capital adequacy relative to climate risk exposures, and other risk measures, as part of its analytic framework and designations.

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[3] Tim McDonnell, " How new flood risk maps could undermine marginalized neighborhoods," Quartz, 5 July 2020. https://qz.com/1876202/new-flood-risk-maps-could-undermine-marginalized-neighborhoods; Teke Wiggin, "'Blue-lining' could be the new redlining, Fed branch warns," Inman, 18 Oct. 2019. https://www.inman.com/2019/10/18/blue-lining-could-be-the-new-redlining-fed-branch-warns/; Sastry, Parinitha. *Who Bears Flood Risk? Evidence from Mortgage Markets in Florida*, MIT Sloan School of Management, 2021. Available at: https://psastry89.github.io/website/psastry_JMP.pdf

[4] https://www.americanprogress.org/events/wall-streets-carbon-bubble/

[5] https://insideclimatenews.org/news/24102022/fossil-fuels-private-equity/

4. The Proposed Analytic Framework lists certain vulnerabilities that most commonly contribute to risk to financial stability: leverage; liquidity risk and maturity mismatch; interconnections; operational risks; complexity and opacity; inadequate risk management; concentration; and destabilizing activities. Are the Council's descriptions of these vulnerabilities appropriate? Should the Proposed Analytic Framework address additional vulnerabilities?

AFREF finds the Council's descriptions of major sources of systemic vulnerability appropriate and does not believe the proposed framework should consider additional vulnerabilities, albeit not closing the door on the potential need for addressing additional vulnerabilities in the future.

5. The Proposed Analytic Framework also provides sample metrics associated with the listed vulnerabilities. Are the proposed sample metrics appropriate for the purposes described in the Proposed Analytic Framework? Are there additional sample metrics that the Proposed Analytic Framework should incorporate?

Yes. AFREF believes the metrics appropriate. We suggest the Council consider including the Net Stable Funding Ratio and measures of rapid asset and liability growth as additional metrics. The Council may also wish to consider qualitative information, concerning an individual firm and in aggregate across multiple firms, for example:

- Business risk management capabilities
- Quality of independent oversight
- Independent board member(s); and
- Excessive outstanding issues from auditors or regulators

6. The Council has identified four channels as most likely to facilitate the transmission of the negative effects of a risk to financial stability: exposures; asset liquidation; critical function or service; and contagion. Do the transmission channels listed in the Proposed Analytic Framework capture the most likely ways in which the negative effects of a risk to financial stability could be transmitted to other firms or markets? Should the Council consider additional transmission channels?

Yes. The transmission channels listed in the proposed framework captures the most likely ways in which negative effects of a risk to financial stability could be transmitted to other firms and markets. We do not believe the Council should consider additional transmission channels at this time.

7. With respect to the vulnerabilities and transmission channels identified in the Proposed Analytic Framework, are there potential interactions between or among these vulnerabilities and transmission channels that the Proposed Analytic Framework should address?

Climate vulnerabilities and their transmission can interact significantly with traditional financial institution vulnerabilities, for example credit risk. Additional aspects of CRFR with implications for financial stability include: its tremendous breadth and non-diversifiable nature,[6] the correlated but uncertain magnitude and timing of shocks that may occur in series and parallel, and the expectation that climate shock propagation will begin in under-regulated and more

[6] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542840

opaque areas of the financial system (investment funds and insurers) before spreading to banks.[7],[8]

[7] *Ibid*.

[8] https://www.nytimes.com/2023/05/07/opinion/climate-change-homeowners-insurance-housing-market.html