HFSC FSOC Oversight Hearing Memo re: Climate Financial Risk
February 6, 2024

In the past year, Republicans in Congress have asserted multiple times that climate change is not a material financial risk. This claim is central to the Committee majority's opposition to various climate financial regulation efforts, including the FSOC's climate financial risk monitoring, the SEC's climate disclosure rule, and the banking regulators' climate risk management guidance. However, it is asserted repeatedly without supporting evidence, and it is directly counter to the position of nonpartisan financial regulators around the world.

Reports and statements from leading global financial authorities emphasize the clear and growing threat posed by climate change to markets, investors, banks, insurers, consumers, and to financial stability. These authorities include the Financial Stability Board, the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Financial Reporting Standards Foundation, the US Treasury, the Financial Stability Oversight Council, the Federal Reserve Board, the Commodity Futures Trading Commission, the Bank of Canada, the Bank of Japan, the Reserve Bank of Australia, the Reserve Bank of India, the Central Bank of Brazil, the Deutsche Bundesbank, the Banco de Mexico, the Banque de France, the European Central Bank (ECB) and the European Systemic Risk Board, the Bank of England, and many others.

The growing financial impacts of climate change are undeniable. Insurance disruptions due in large part to climate change are becoming the new normal and climate shocks are making parts of America uninsurable. Worse still, there is evidence that the insurance crisis is leading to credit rationing that disproportionately harms low-income consumers. A forthcoming data call from the Federal Insurance Office (FIO) seeks to merely identify the magnitude and trends of insurance disruption, but Republicans have responded by attempting to repeal FIO's subpoena and enforcement power and even eliminate the office altogether.

Recent proposed guidance from the FSOC highlights that climate change could contribute to financial crises, and that climate impacts that disproportionately harm low-income, minority, and underserved communities are a threat to financial stability. FSOC's 2023 Annual Report underscores this point, observing, "**Climate-related impacts and events continue to impose significant costs on the public and the economy." It's clear that the growing costs are being spread to all taxpayers."** Climate change is also increasingly recognized as a threat to the safety and soundness of banks as well as a driver of inflation.

These developments must be monitored by regulators for their financial stability implications and impact on consumers, and FSOC is the regulator best positioned to coordinate these efforts and direct agency activities that can safeguard financial stability. That is why the FSOC was created following the global financial crisis.

Key Points

- **Climate risk is financial risk**
  - The most recent report from the IPCC warns that physical risks from climate change already threaten banks' assets and operations, while transition risks are predicted to create losses exceeding $1 trillion. The SVB banking collapse highlights how hidden risks can emerge suddenly, fueling panic that quickly infects the entire sector and requires federal intervention.
  - Real estate in the U.S. is estimated to be overvalued by $121-237 billion due to unpriced flood risk driven by climate change, with low-income households facing the greatest risk of losing home equity, as was the case in the housing crisis of 2007-08 that led to the financial crisis.
  - Low-carbon investment strategies were associated with better investment returns 65% of the time in a set of over 1000 studies published from 2015 to 2020.[1] The S&P500 energy index has a 10-year annualized return of -0.2% compared to 10.0% percent for the overall S&P500,[2] as of January 2024.

- **The FSOC 2023 Annual Report identified climate as a significant threat to financial stability**
  - *"Physical climate risk and its intersection with commercial and residential real estate vulnerabilities remains a primary area of interest for the Council. Given the critical role of real estate in the economy and the financial system and how it affects the remits of multiple Council member agencies, the Council recommends that agencies collaborate on analysis related to the* ***intersection of physical risk, real estate, and insurance in particular.***
  - *"Climate-related impacts and events are expected to increase the risk of property damage and loss…In 2023, multiple insurers announced their intent to leave or implement a pause on writing new policies in large markets including Florida, California, and Louisiana, due to the increased risk of natural disasters.* ***These announcements portend the unfortunate reality that more and more borrowers will be faced with renewal concerns or difficulty obtaining affordable initial insurance policies when they buy a home. As coverage becomes inaccessible or prohibitively expensive in a given location, home values may decline there, and fewer loans in the area may be originated or eligible for acquisition by the [Government Sponsored] Enterprises."***

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[1] Whelan *et al.*, "ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015-2020," NYU Stern Center for Sustainable Business and Rockefeller Asset Management. 2021.
https://www.stern.nyu.edu/sites/default/files/assets/documents/NYU-RAM_ESG-Paper_2021%20Rev_0.pdf

[2] S&P500 Energy. https://www.spglobal.com/spdji/en/indices/equity/sp-500-energy-sector/#overview; S&P500. https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview

- **Climate change is fueling a property insurance crisis**[3]
    - Following years of heavy losses from climate-exacerbated hurricanes, fires, floods, and other natural disasters, insurers in states across the country are raising rates and pulling out of markets altogether.[4]
    - Farmers Insurance announced in July 2023 that it will pull out of Florida, making it the latest of many insurance companies to do so within the last year.[5]
    - In fact, 15 Florida property insurers have become insolvent since 2020, and at least 400,000 Floridians lost access to property insurance in 2022 alone.[6]
    - In Louisiana, 11 insurers have gone bankrupt in the last two years and 10 others have left the state.[7] California has also seen a number of insurers limit their underwriting in its market in recent months, including State Farm, among others.

Potential Questions

GOP political interference with financial risk management and regulation

Q: Should regulators ignore certain material risks based on the politics of the party in power, or should their risk monitoring be consistent across administrations?

- **Are fiduciaries allowed to ignore certain material risks because they think the topic is too politically charged? Or are they required to instead consider all material risks?**

Physical risk and the real estate bubble

Q: Recent research shows that real estate in the U.S. is estimated to be overvalued by $121-237 billion due to unpriced flood risk driven by climate change, with low-income households facing the greatest risk of losing home equity, as was the case in the housing crisis of 2007-08 that led to the financial crisis. **What will happen to consumers when that bubble pops?**

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[3] Washington Post, "Climate change is fueling an insurance crisis. There's no easy fix." June 2023. https://www.washingtonpost.com/politics/2023/06/27/climate-change-is-fueling-an-insurance-crisis-there-no-easy-fix/

[4] The Guardian, "Florida rocked by home insurance crisis: 'I may have to sell up and move'," July 2023. https://www.theguardian.com/us-news/2023/jul/15/florida-hurricane-insurance-crisis-climate

[5] Hannah Morse, Farmers Insurance is leaving its business in Florida, USA Today, July 12, 2023. Available at: https://www.usatoday.com/story/money/2023/07/11/farmers-insurance-leaving-florida-market/70403832007/

[6] Jack Sanner, Florida's Climate-Fueled Insurance Crisis, Boston University School of Law Review of Banking and Financial Law, May 17, 2023. Available at: https://www.bu.edu/rbfl/2023/05/17/floridas-climate-fueled-insurance-crisis/; Lori Rozsa and Erica Werner, Florida's Insurance Woes Could Make Hurricane Ian's Wrath Even Worse, Sept. 30, 2022. Available at: https://www.washingtonpost.com/climate-environment/2022/09/30/ian-florida-economy-insurance/

[7] Thomas Frank, Growing Storms Push Shrinking Louisiana Insurers Into Failure, E&E News, Nov. 22, 2022. Available at: https://www.eenews.net/articles/growing-storms-push-shrinking-la-insurers-into-failure/

Climate as a driver of food insecurity and inflation

Q: A recent working paper from the European Central Bank found that climate change will result in annual increases in both food and headline inflation worldwide, concluding that "climate change poses risks to price stability by having an upward impact on inflation." **Is the FSOC taking any steps to better understand the implications of climate change on inflation?**

Climate impacts on homeowners, insurers, and banks

Q: In recent years, consumers in climate vulnerable areas have seen the costs of their homeowners insurance policies skyrocket. Insurers have even begun to retreat from entire states. FSOC's most recent annual report observes that these climate-related impacts and events "continue to impose significant costs on the public and the economy." **If more and more of the nation's housing stock is becoming climate vulnerable, and less and less is covered by insurance, isn't that a major potential threat to both taxpayers and financial stability?**

- **What happens to a bank's and non-bank lender's mortgage book if more of those homes are uninsured?**

Fossil fuel expansion as a driver of climate financial risk

Q: Secretary Yellen, can you name the earliest known year that the fossil fuel industry knew that their products were changing the climate, and that this posed "considerable significance to civilization"?

[Secretary Yellen won't know the answer.]

Well, the answer is 1954.[8]

And Secretary Yellen, what year did the public find out that the fossil fuel industry knew way back in 1954 about how fossil fuels are a major contributor to climate change?

[Secretary Yellen won't know the answer.]

Well, the answer is this year. 2024. Or to be exact, a week ago today, January 30, 2024[9].

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[8] The Guardian, "Smoking gun proof': fossil fuel industry knew of climate danger as early as 1954, documents show," 30 Jan 2024. https://www.theguardian.com/us-news/2024/jan/30/fossil-fuel-industry-air-pollution-fund-research-caltech-climate-change-denial and https://www.desmog.com/2024/01/30/fossil-fuel-industry-sponsored-climate-science-1954-keeling-api-wspa/

[9] See publish date of citation 8

The fossil fuel industry knew for *seventy years* that its industry was accelerating climate change and for *seventy years* chose to withhold critical science-based information from its investors, the public, and even to its own workers on how its operations could lead to an unlivable planet, or catastrophic, global financial chaos.

Now, do you know what percentage of global greenhouse gas emissions come from the fossil fuel industry?

[Secretary Yellen most likely will not know the answer.]

To date, the fossil fuel industry accounts for over 75 percent of global greenhouse gas emissions,[10] and US banks, asset managers, and insurers are some of the largest financiers of the industry, and deeply exposed to its financial risks[11].

Now the fossil fuel industry is uniquely responsible for driving climate risk so it seems quite odd that financial regulators would overlook the risks that ongoing finance towards *expanding* the sector poses to our financial system, and to our planet.

So my final question to you is -

Why is it that regulators – whose job is to protect working people from financial systemic risks – are not focusing on the main *driver* of climate systemic financial risk?

[Secretary Yellen probably will not answer.]

We urge you and the FSOC to not only look at the physical impacts of climate change, but also the financial drivers. If we don't reckon with the financial drivers of climate change, like finance for new fossil fuel projects, we will be stuck merely responding to ever worsening physical climate impacts with no way to actually lower the level of risk within the system.

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[10] UN, "Causes and Effects of Climate Change," Accessed Feb 2024. https://www.un.org/en/climatechange/science/causes-effects-climate-change#:~:text=Fossil%20fuels%20%E2%80%93%20coal%2C%20oil%20and,they%20trap%20the%20sun's%20heat

[11] Sierra Club *et al*., "Banking on Climate Chaos," 2023. https://www.bankingonclimatechaos.org/wp-content/uploads/2023/08/BOCC_2023_vF.pdf ; CAP, Sierra Club, "Wall Street's Carbon Bubble," 2021. https://carbonbubble.net