Director Steven Seitz
Federal Insurance Office
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: Federal Insurance Office Request for Information on the Insurance Sector and Climate-Related Financial Risks

Director Seitz,

The Americans for Financial Reform Education Fund appreciates this opportunity to comment on the Federal Insurance Office's request for information on insurers' growing climate risk exposure; how the activities of insurance companies contribute to climate change, racial and economic inequality; and associated systemic risks, and the data needs, coordination, resources, and regulatory responses necessary to combat this urgent threat to the financial system.

The insurance industry, controlling $4.7 trillion in investments, is by far the largest set of investors outside of the banking system with exposure to the negative effects of climate change and the transition to clean energy, as well as one of the largest investors in companies that contribute to climate change.

Insurance companies are both *exposed* to climate risk and *drive* additional systemic climate risk through multiple channels. They have exposure to physical risks in their underwriting and investments in climate-vulnerable properties, businesses and communities; exposure to transition risk through their underwriting and investments in fossil fuel projects and other emissions intensive industry; and they drive systemic risk through the greenhouse emissions that they finance and underwrite and through the ways they exit insurance markets as climate change accelerates.

The systemic risks created by this cycle of dangerous activity--using property insurance premiums to fund climate damaging investments which further endanger policyholders--fall disproportionately on BIPOC communities and exacerbate racial and economic inequality.

FIO should collect and disseminate climate risk data and support regulatory efforts towards standardized disclosures and enhanced supervision related to climate risk and racial and economic justice.

A fundamental challenge for financial actors in responding to climate change is a lack of standardized methods for data collection, disclosure, and the incorporation of that data and climate scenarios into governance frameworks, risk management, business strategies and supervision by regulators. FIO has a key role to play in convening stakeholders and should work with the Office of Financial Research (OFR), state regulators, the National Association of Insurance Commissioners (NAIC), and individual insurers to collect, analyze, and disseminate climate risk data, and to develop methods for incorporating climate data and scenarios into prudential supervision and regulation.

With regard to physical risks from climate-fueled disasters and chronic damages, FIO should collect and disseminate data from insurers on property claims payouts, claim rates, premium rate increases, rates of nonrenewals, claims denial, and systematic regional exits of property insurance markets (or "bluelining") in climate-impacted areas, which often occurs without adequate disclosure.[1] FIO should work to identify trends, especially in areas following climate disasters, and disaggregate data to determine disparate impacts on the affordability and availability of coverage in underserved communities and communities of color. FIO should work with FEMA, NOAA, EPA and other risk modeling and data providers to ensure that up-to-date disaster risk maps and data are being incorporated properly into property insurance underwriting, and survey insurers on their usage and needs for better data and models.

Insurers and regulators also must begin to use climate scenario analysis and stress testing to better understand their risks from climate change, ensure their solvency in the face of future disasters, regulatory and market changes, and to inform policyholders about their own forward-looking risks and the likely cost increases of insurance coverage.

FIO should work with insurers and state regulators to incorporate climate scenarios--such as those outlined[2] by the Network for Greening the Financial System (NGFS)--into risk management and supervision and examinations, and publish the results. Scenarios should include:

- a 1.5 degree Celsius warming scenario consistent with science-based emissions targets
- a 2 degree scenario
- a 3 degree scenario
- the extent to which a firm's decarbonization goals and climate strategy depend on the availability of carbon offsets, factoring in orderly and disorderly transitions.

State regulators should incorporate scenario analysis and climate stress testing into supervision and examinations for insurers. The New York Division of Financial Services was the first state regulator to issue climate-related supervisory guidance[3] and incorporate climate risk into

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[1] CNBC, "Banks consider climate risk for home loans, a process called 'underwaterwriting' or 'blue-lining'" https://www.cnbc.com/2021/09/20/blue-lining-and-underwaterwriting-banks-consider-climate-change-risk.html

[2] Network for Greening the Financial System Scenarios Portal, https://www.ngfs.net/ngfs-scenarios-portal/

[3] New York Department of Financial Services, Insurance Circular Letter No. 15 (2020). https://www.dfs.ny.gov/industry_guidance/circular_letters/cl2020_15

examinations for insurers, and FIO should support efforts to expand such actions to other states.

Insurers must provide accurate, comparable, and decision-useful climate disclosure so that regulators, investors, market participants, and the public are able to assess the climate risk that insurance companies face and hold them accountable for their contribution to the climate crisis.

FIO should support efforts to require disclosure of Scopes 1, 2, and 3 greenhouse gas emissions[4] (including financed emissions) and the efforts of the Partnership for Carbon Accounting Financials (PCAF) and the Net Zero Insurance Alliance to develop an insured emissions metric. FIO should also support efforts by state regulators to require qualitative disclosures in line with the standards[5] of the Task Force on Climate-Related Financial Disclosures (TCFD) and work with individual insurers to develop robust net zero emissions commitments with interim targets, and report back on industry-wide progress and best practices.

Underserved communities in particular face a host of challenges related to climate risk, including lacking financial resources and access to capital to build climate resilience, higher levels of physical vulnerability due to location and the built environment, and fewer financial resources for post-disaster recovery.[6] Insurers and state regulators have a responsibility to proactively consider and mitigate potential disparate impacts related to affordability and availability of property insurance as well as the impact of insurers' investments in lower income communities and communities of color, which bear disproportionately the harms of toxic fossil fuel pollution that insurers' finance and insure.

It's critical that environmental, racial, and economic justice is incorporated into climate supervision and enhanced disclosure requirements. FIO should work with insurers to develop strategies around promoting environmental, racial, and economic justice and enhance outreach and engagement efforts towards affected or vulnerable communities and clients.

FIO should address the cycle through which investment portfolios - invested in riskier assets to respond to climate change driven losses - in turn contribute to further climate change

Insurance companies are exacerbating the losses on their policy books as they try to make up for losses that result from the greater frequency and costs of disasters resulting from climate change.

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[4] As defined by the GHG Protocol, Scopes 1 and 2 GHG Inventory Guidance, https://ghgprotocol.org/sites/default/files/Guidance_Handbook_2019_FINAL.pdf, and the Corporate Value Chain (Scope 3) Standard, https://ghgprotocol.org/standards/scope-3-standard

[5] Recommendations of the Task Force on Climate-Related Financial Disclosures, https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

[6] EPA. 2021. Climate Change and Social Vulnerability in the United States: A Focus on Six Impacts. U.S. Environmental Protection Agency, EPA 430-R-21-003.https://www.epa.gov/system/files/documents/2021-09/climate-vulnerability_september-2021_508.pdf

Losses by property and casualty insurers have been trending higher since the 1980s, marked by certain catastrophic years where losses are many times those of the prior years. Insurers in 2017 experienced a record $350 billion in losses following Hurricanes Harvey, Irma, and Maria as well as from a number of wildfires across Northern California. Prior to 2012, insured losses were no higher than $50 billion in any given year with the exception of Hurricane Katrina in 2005 when insured losses reached $250 billion. Insured losses however exceeded $100 billion again in 2020.[7]

In order to generate greater investment income to make up for insured losses in 2017, property and casualty insurers invested larger portions of their investment portfolios in riskier corporate debt and securitizations,[8] many of which are widely invested in fossil fuel companies.[9] There is a vicious cycle here: after taking losses due to climate change, insurers systemically ended up taking on greater amounts of credit risk and further financing the very activities that drive climate change caused losses.

FIO should investigate insurance company financing of shadow banking; true extent of potential losses from stranded assets unknown

Since 2008, insurance companies have been playing a much greater role in providing financing to 'real economy' companies, in the process stepping into a role traditionally played by banks. Such activity is often referred to as "shadow banking" and takes place in the form of insurers investments in corporate debt and corporate loans packaged into securitizations called Collateralized Loan Obligations (CLOs).

CLOs have been active providers of financing to the shale oil boom in the past decade.[10] And insurers have contributed significantly to CLO growth, with the industry's holdings of CLOs growing by an astounding 863% over the past decade from $13 billion in 2009 to $125 billion by 2019. Corporate loans by insurance companies also grew 132% from $18 billion to $42 billion during that same period.

As FIO seeks to understand the full extent of carbon emissions being financed by the portfolios of insurers, the department and state regulators must also have the ability to look-through to the underlying companies being financed by securitizations such as CLOs.

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[7] NOAA National Centers for Environment Information. https://www.ncdc.noaa.gov/billions/
[8] Fringuellotti, Fulvia and Santos, Joao A.C. Federal Reserve Bank of New York. Insurance Companies and the Growth of Corporate Loans' Securitization. August 2021. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr975.pdf
[9] McHale, Cynthia. Ceres. Assets or Liabilities? Fossil Fuel Investments of Leading U.S. Insurers. May 24, 2016. https://www.ceres.org/resources/reports/assets-or-liabilities-fossil-fuel-investments-leading-us-insurers
[10] Wethe, David and Crowley, Kevin. Bloomberg. Shale's Bust Shows Basis of Boom: Debt, Debt, and Debt. Jul 23, 2020. https://www.bloomberg.com/news/articles/2020-07-22/shale-s-bust-shows-basis-of-boom-debt-debt-and-debt-quicktake?sref=f7rH2jWS

They also need this information to understand risks to insurers. Over the past decade, oil and gas explorers have burned through an estimated $342 billion of capital, and financing fossil fuel companies has led CLOs and other debt investors to take losses in 2015 and 2016[11] and again in early 2020 before the pandemic.

It is therefore vital for FIO to accurately assess how much of insurers portfolios are directly and indirectly exposed to fossil fuel companies that may become stranded assets as the energy transition accelerates. FIO and state insurance regulators should consider utilizing data services that receive monthly updates as to the underlying holdings of CLOs and other securitizations.

Given the large role that insurance companies play in financing shadow banking and the vulnerabilities insurers face from either absorbing large capital shocks from climate change or in financial losses on their portfolio from the energy transition, FIO should publish a quarterly report that summarizes the insurance industry's investment portfolio holdings, including looking through securitizations such as CLOs, including information on how much the industry is contributing to Scopes 1, 2, and 3 greenhouse gas emissions.

In addition to action by FIO, to the extent that FSOC finds that insurers are posing threats to the financial system through their extensive shadow banking financing and/ or their exposure to climate-related risks, it should use its authority to designate individual insurers as Systemically Important Financial Institutions (SIFIs).

FIO needs to work with the NAIC and state regulators to reverse the loosening of capital requirements

Climate-related insurance losses are continuing to rise, but these risks have not been incorporated into the NAIC's risk based capital (RBC) charges. As long as NRSRO ratings, which determine the NAIC's capital charges, ignore climate risks, there is a serious danger that insurance companies will be unprepared and potentially undercapitalized against future losses.

In the context of this failure to incorporate climate risk into capital standard setting, it is particularly alarming that the NAIC is in fact loosening the capital standards for "junk" or "sub-investment grade" investments[12] based on arguments from the American Academy of Actuaries (AAA) and Moody's that the historical loss rates from the 1970s and 1980s justify new lower capital charge levels.

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[11] Haunss, Kristen. Reuters. Energy-heavy US CLOs trade down in secondary amid volatility. Nov 13, 2015. https://www.reuters.com/article/energy-clo/trlpc-energy-heavy-us-clos-trade-down-in-secondary-amid-volatility-idUSL1N1381BS20151113

[12] MetLife Investment Management. A Very Long Engagement: Asset Allocation Implications of U.S. Life Insurance Risk-Based Capital Charges. Aug 5, 2021. https://investments.metlife.com/content/dam/metlifecom/us/investments/insights/research-topics/Insurance-am/a-very-long-engagement/MIM-A-Very-Long-Engagement-Asset-Allocation-Implications-of-US-Life-Insurance-Risk-Based-Capital-Changes.pdf

Meanwhile, investors in higher-rated and supposedly safer debt have already been surprised by losses due to catastrophic climate events. One example is the $17 billion of bonds issued by utility company Pacific Gas & Electric Co. (PG&E) where the Northern California wildfires of 2017 and 2018 led the company to default.[13] Going into 2017, PG&E held the sixth-highest investment grade rating of A2/A from the NRSROs.

The case of PG&E is not an isolated incident. Following the sudden February 2021 freeze in Texas, another utility company - Brazos Electric Power Cooperative - filed for bankruptcy after holding the sixth-highest investment grade rating of A from S&P Global a week earlier.[14]

FIO must coordinate with the NAIC and state regulators and incorporate the scenarios outlined under NGFS to ensure that insurers are adequately insured for what are expected to be more frequent and increasingly more costly climate events.

FIO needs to better monitor the effects of private equity management of insurers portfolios

Insurers chasing after higher-yielding securities following natural disasters highlights an uncomfortable reality for regulators: in a monetary policy environment where interest rates have been set close to 0% to urgently support an economic recovery and foster maximum employment, insurance companies are moved to take on greater amounts of risk as returns across corporate debt and securitizations fall lower and lower.[15]

The current yield on “junk” corporate bonds averages around 4% compared to insurers’ target returns of 7%[16]; as a consequence, insurers are either taking on much greater amounts of credit risk to reach their targets or outsourcing their investment portfolios to private equity firms which are not subject to the same disclosure requirements.

To capitalize on such demand, private equity giant Blackstone in 2018 created its Blackstone Insurance Solutions group to serve this market of insurers looking for higher-yield private

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[13] Oh, Sunny. MarketWatch. PG&E’s slide into bankruptcy would mark third largest investment-grade default since 1998. Jan 15, 2019. https://www.marketwatch.com/story/pges-slide-into-bankruptcy-would-mark-third-largest-investment-grade-default-since-1998-2019-01-15

[14] Jacobs, Justin and Meyer, Gregory. Financial Times. Texas power co-op files for bankruptcy as storm fallout mounts. Mar 1, 2021. https://www.ft.com/content/5a7adedf-8328-42a7-9653-d8a88ace3370

[15] Ice Data Indices, LLC, ICE BofA US High Yield Index Effective Yield [BAMLH0A0HYM2EY], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/BAMLH0A0HYM2EY, November 9, 2021.

[16] Scism, Leslie and Light, Joe. Wall Street Journal. Draining Away! Nov 16, 2012. https://www.wsj.com/articles/SB10001424127887324595904578121484233279270

investments.[17] Insurers have become such reliable sources of new capital and fees for the private equity firms that in the instance of Blackstone, they now make up a third of the firm's assets.[18]

Since then, several other private equity firms have acquired insurance company assets, including KKR acquiring insurer Global Atlantic, the Carlyle Group acquiring Fortitude Re, Apollo Global Management acquiring the remainder of annuity provider Athene Holding, and Blackstone entering into an agreement with AIG over the management of its $50 billion life and retirement portfolio.[19]

Many of these same private equity firms continue to finance new pipelines and extend lifelines to coal companies.[20]

FIO in conjunction with state regulators should conduct a separate study on the growing private equity ownership and management of the insurance industry, including assessing how much of their portfolios are being invested directly in both public and private fossil fuel assets after such transfers. Beyond the climate context, FIO should look generally at the impacts of PE ownership and control of insurance assets, including impacts on opaque and illiquid investments.

Conclusion

We appreciate FIO's formal acknowledgement that climate risks pose systemic risks to the financial system. We also commend FIO for recognizing the significance of the role it can play in combating climate change as a monitor for the insurance industry and policy coordinator across state and federal agencies.

Insurers face great physical risks to their policy liabilities from climate change and they play a major role in financing the industries contributing to climate change through their collective $4.7 trillion investment portfolio.

We urge the Treasury Federal Insurance Office to:

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[17] Franklin, Joshua. Reuters. Blackstone's new insurance unit targets $100 billion in assets. Jan 8, 2018. https://www.reuters.com/article/us-blackstone-group-insurance/blackstones-new-insurance-unit-targets-100-billion-in-assets-idUSKBN1EX2ES

[18] Gara, Antoine. Financial Times. Blackstone braces for higher inflation as earnings hit record. Oct 21, 2021. https://www.ft.com/content/10de97da-30e9-4c92-a3a7-5da251706c3e

[19] Blackstone. AIG Announces Strategic Partnership with Blackstone for its Life & Retirement Business and Sale to Blackstone of Certain Affordable Housing Assets. Jul 14, 2021. https://www.blackstone.com/press-releases/article/aig-announces-strategic-partnership-with-blackstone-for-its-life-retirement-business-and-sale-to-blackstone-of-certain-affordable-housing-assets/

[20] Tabuchi, Hiroko. New York Times. Private Equity Funds, Sensing Profit in Tumult, Are Propping Up Oil. Oct 13, 2021. https://www.nytimes.com/2021/10/13/climate/private-equity-funds-oil-gas-fossil-fuels.html#commentsContainer

- Work together with state regulators, the NAIC, OFR, and individual insurers to collect the climate data necessary to conduct a thorough scenario-analysis under NGFS to set the appropriate prudential standards for insurers. Such data includes:
    - Scope 1, 2, and 3 emissions, including financed and insured emissions
    - Qualitative disclosures in-line with those of the TCFD.
    - In conjunction with FEMA, NOAA, and EPA up-to-date disaster maps and risk modeling to incorporate into supervision, and to assess disparate impact for lower income communities and communities of color.
- As a non-voting member of FSOC, recommend individual insurers it determines should be designated nonbank SIFIs, including financed greenhouse emissions in the criteria for designation.
- Work with individual insurers on setting goals and achieving net zero emissions targets
- Subscribe to the necessary data services to be able to look through the underlying holdings of securitizations such as CLOs to more comprehensively assess on a quarterly basis the risks insurers face from both transition risks as well as their contributions to scope 1, 2 and 3 emissions
- Monitor the impacts of insurers outsourcing of portfolio management to private equity, as well as PE firms' acquisition of insurers, and whether PE firms are increasingly allocating insurers investments into more opaque investments that contribute heavily to carbon emissions.

We appreciate your consideration of these issues. If you have any questions please do not hesitate to reach out to Andrew Park (andrew@ourfinancialsecurity.org) and Alex Martin (alex@ourfinancialsecurity.org).