United States Senate

May 14, 2020

Mr. Robert Litterman
Chairman
Climate-Related Market Risk Subcommittee
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Dear Mr. Litterman:

Thank you for your leadership as chairman of the Climate-Related Market Risk Subcommittee (the Subcommittee). As the Subcommittee prepares its report to the Market Risk Advisory Committee (MRAC), we urge you to recommend that our nation's financial regulators take immediate steps to identify and manage climate risks within their jurisdictions.

The United States' current regulatory regime allows financial institutions to ignore climate change when they measure risk. When the Commodity Futures Trading Commission (CFTC) voted to establish the subcommittee in July 2019, it became the first federal financial regulator to formally examine the risks that climate change poses to financial stability. Meanwhile, the CFTC's peers are allowing systemic risk to build in our financial system, even as their counterparts around the world are taking steps to identify climate financial risks. Our regulators must develop standards for climate-related scenario analysis, stress testing, governance requirements, and disclosures, and they must incorporate those standards into their core market risk assessments and supervisory practices.

The economic and financial impacts of the COVID-19 pandemic demonstrate the disruption that can occur when markets underestimate risks that are well known and highly probable, but are poorly understood and inaccurately priced. We cannot make the same mistake with climate change. This pandemic has shown us how severe the economic impacts can be when we are poorly prepared for these types of risks. We also cannot use the pandemic as an excuse to put off planning for climate risks—whether it is the risk that the market will rapidly re-price the value of oil and gas-related assets, or the risk that more severe natural disasters and chronic phenomena like sea level rise and extreme heat will wreak havoc on the economy by reducing household income and damaging or destroying homes and businesses.

Despite the predictable nature of these disruptions with respect to climate change, our financial system is flying blind. Public companies are not adequately disclosing to investors how climate risks will impact their business activities, supply chains, assets, and financial planning. Banks are not incorporating climate change into their core risk management practices, preferring to silo climate responsibilities within corporate sustainability divisions. Asset managers are screening for climate risks only in niche ESG funds, if at all. Financial regulators, meanwhile, have no standardized tools for assessing climate financial risks at the institutions they supervise, and there is no effort underway to assess how the financial system as a whole might handle those risks. Even if federal regulators were inclined to protect our financial system from climate risks, they have not made enough progress in developing the necessary data, tools, and expertise.

The massive fiscal and monetary policy response to the COVID-19 pandemic underscores the cost of neglecting an economy-wide risk. Furthermore, as the Federal Reserve and Department of Treasury spend trillions of taxpayer dollars to prop up the economy in unprecedented loan and asset-purchase programs, they are doing so without any means of assessing whether their investments are vulnerable to short-, medium-, and long-term climate financial risks. Relying only on pro forma earnings figures and credit ratings from agencies that have also failed to account for climate change, our regulators' current interventions to support the economy could make a climate financial crisis more likely. Their actions today may very well undermine their mandate to promote financial stability in the future. In fact, the recent changes the Federal Reserve made to its Main Street Lending Facility seem specifically designed to benefit the fossil fuel industry. This is precisely the opposite of what the Fed's international counterparts are starting to do: they are choosing to exclude climate-risky assets, which are both vulnerable to climate risks and exacerbate those risks.[1]

Federal financial regulators should take immediate steps to safeguard the financial system and economy from climate risks. We therefore ask that you consider the following recommendations:

1) The Federal Reserve should conduct stress tests on individual financial institutions to measure their resilience to climate-related financial risks.
2) The Federal Reserve and the Financial Stability Oversight Council (FSOC) should assess climate-related risks to the financial system as a whole.
3) The Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA) should improve their supervisory practices to require firms to incorporate climate change into their core risk management and governance practices.
4) The Securities and Exchange Commission (SEC) should require high-quality, consistent, and comparable climate risk reporting from public companies, without which investors, rating agencies, and the general public are in the dark.
5) The SEC should also require rating agencies to incorporate climate financial risk into their core rating products, rather than relegating it to ESG-focused side products.
6) Finally, while insurance is largely regulated at the state level, the Federal Insurance Office (FIO) can and should assess the industry's vulnerability to climate risks and make recommendations to state commissioners to ensure that insurance companies are resilient to climate risks.
7) The FIO should also assess the risk to households, businesses, state and local economies, and the financial system if the insurance industry's response to climate risk is to stop offering certain types of coverage or to withdraw from some markets altogether.

Financial firms can make strides on their own to understand and manage their exposure to climate-related financial risks. However, there are few tangible advantages to being a first mover and preemptively refusing to work with riskier clients. Banks have shown a willingness

[1] https://www.ngfs.net/sites/default/files/medias/documents/ngfs-a-sustainable-and-responsible-investment-guide.pdf

to exit sectors that pose significant reputational risks, like thermal coal and Arctic drilling. But it is unrealistic to expect these firms to voluntarily write down assets, or entirely cede underwriting and advisory fees or trading revenues to their less scrupulous competitors. The market can only go so far on its own; it is the government's responsibility to establish clear expectations for what constitutes climate risk management, and to mandate consistent behavior throughout the financial sector. Financial institutions would also welcome guidance and technical assistance from regulators in developing scenario analyses, and otherwise developing tools to translate climate impacts into useful financial metrics. The work of assessing climate financial risks is a substantial task, and one the industry reasonably hopes federal regulators will approach in a consistent manner across firms. It is therefore essential that our regulators lead the way in developing the information and tools necessary to quantify these risks.

Thank you for your consideration of these requests, and for your dedication to ensuring the resilience of our financial system to climate risks.

Sincerely,

BRIAN SCHATZ
U.S. Senator

SHELDON WHITEHOUSE
U.S. Senator