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October 2, 2024

Financial Stability Oversight Council
1500 Pennsylvania Avenue
NW, Room 2308, Washington, DC 20220

Dear Members of the Financial Stability Oversight Council (FSOC),

We are writing to urge you to address the growing threats to financial stability present in the insurance sector by using FSOC's authority to designate key insurers as systemically important nonbanks. The destabilizing effects of the climate crisis on U.S. insurers are a threat to financial stability, and mitigating these risks falls well within FSOC's mandate. This letter details American International Group, Inc's (AIG) suitability for designation based on the vulnerabilities outlined in FSOC's 2023 analytical framework.[1] FSOC should move quickly to evaluate the suitability of AIG and other large U.S. insurers for designation before a financial crisis necessitates substantial federal intervention. Climate-driven instability in the insurance sector has the potential to send a cascade of risks through the financial system and U.S. economy. FSOC must use its full authority to address these risks with the urgency the climate crisis demands.

## Introduction

The ability to subject nonbank financial companies to enhanced supervision was born out of the 2008 financial crisis, where large, complex, and interconnected nonbank financial companies, such as AIG, both contributed to the crisis and nearly collapsed as a result of it.[2] Congress determined that to prevent another financial crisis, insurance companies and other non-bank financial institutions that could threaten financial stability—either through their own material distress or through their activities—need enhanced federal supervision. The *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) gives FSOC the authority to designate nonbank financial companies for supervision by the Board of Governors of the Federal Reserve System and subject these firms to prudential standards if either material financial distress at the

[1] Analytic Framework for Financial Stability Risk Identification, Assessment, and Response 88 FR 78026, https://www.govinfo.gov/content/pkg/FR-2023-11-14/pdf/2023-25055.pdf.
[2] The Financial Crisis Inquiry Report, Financial Crisis Inquiry Commission, (January 2011), https://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the firm's activities could pose a threat to financial stability.[3]

In the years since the financial crisis, the need for FSOC to address financial stability threats in the nonbank financial system has increased. The sector has grown in size—the Financial Stability Board estimates assets of U.S. nonbank financial institutions totaled $19.2 trillion in 2022, growing from $14.2 trillion in 2014.[4] As financial activity has migrated from banks to nonbanks, so have risks.[5] The nonbank financial sector is increasingly home to liquidity mismatches, high leverage, and complex interconnectivity between institutions.[6] Although the migration of risks has been well documented by regulators, measures to address these sweeping changes to the financial system have not kept pace. In a 2019 letter to former Treasury Secretary Mnuchin opposing the rollback of FSOC's previous designation guidance, Chair Yellen, alongside former Federal Reserve Chair Ben Bernanke and former Treasury Secretaries Timothy Geithner and Jacob Lew, highlighted the need to address the migration of risks with regulatory tools:

> A fundamental feature of a market oriented, innovative financial system is that—over time—risk will migrate around the prudential constraints that apply to banks, shrinking the effective scope of those defenses, and leaving the overall financial system more fragile. This is what happened in the decade leading up to the crisis, and the failure of prudential regulation to prevent this is a critical reason why the crisis was so severe and challenging to manage.[7]

On November 17, 2023, FSOC published interpretive guidance describing the process it will take to determine if a nonbank financial company should be designated as systemically important.[8]

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[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 113, 124 Stat. 1376, 1398 (2010).

[4] Global Monitoring Report on Non-Bank Financial Intermediation, Financial Stability Board, (December 18, 2023), https://www.fsb.org/wp-content/uploads/P181223.pdf;
Global Shadow Banking Monitoring Report 2015, Financial Stability Board, (November 12, 2015), https://www.fsb.org/wp-content/uploads/global-shadow-banking-monitoring-report-2015.pdf.

[5] Antonio Garcia Pascual et al., Nonbank Financial Sector Vulnerabilities Surface as Financial Conditions Tighten, International Monetary Fund, (April 4, 2023), https://www.imf.org/en/Blogs/Articles/2023/04/04/nonbank-financial-sector-vulnerabilities-surface-as-financial-conditions-tighten; Global Shadow Banking Growth Increases Systemic Risks, Fitch Ratings, (May 21, 2019), https://www.fitchratings.com/research/non-bank-financial-institutions/global-shadow-banking-growth-increases-systemic-risks-21-05-2019.

[6] Martin J. Gruenberg, *Remarks by FDIC Chairman Martin J. Gruenberg at the Exchequer Club on the Financial Stability Risks of Nonbank Financial Institutions*, Washington, DC (September 20, 2023), https://www.fdic.gov/news/speeches/2023/spsept2023.html.

[7] Timothy Geithner et al., Letter to Secretary Steven T. Mnuchin and Chairman Jerome H. Powell (May 13, 2019), Re: Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (RIN 4030-ZA00), https://int.nyt.com/data/documenthelper/887-bernanke-geithner-lew-yellen-letter/a22621b202dfcb0fe06e/optimized/full.pdf#page=1.

[8] Guidance on Nonbank Financial Company Determinations 12 CFR 1310, https://www.govinfo.gov/content/pkg/FR-2023-11-17/pdf/2023-25053.pdf.

This guidance is an important step in bolstering FSOC and the designation tool. However, guidance alone is insufficient. FSOC's designation authority is useful only if it is actively deployed to address risks before they cause systemic instability. Designations are necessary both to mitigate financial stability threats from firms when they arise as well as deter firms from activities that contribute excess risk to the financial system.

The need for FSOC to address threats to financial stability in the nonbank financial sector is made all the more urgent and essential by the climate crisis. Nonbank financial companies are already facing heightened stress from large and repeated climate-related shocks. Large insurers, asset managers, and private equity firms are also creating significant risks to the financial system through their insured or financed emissions.[9] As the effects of climate change become more severe, the impacts on financial stability will grow. The increase in frequency and severity of wildfires, floods, hurricanes, and droughts will disrupt supply chains, compress corporate profits, drive up insurance claims, reduce the availability of insurance, and generally limit the ability of affected borrowers to repay debt.[10] Not only are these harms already devastating communities, disproportionately low income communities and communities of color, but credit and market risks related to these impacts will spread through the interconnected financial system.[11]

U.S. regulators have taken initial steps to address the risks climate change poses to the banking sector. On October 30, 2023 the Federal Reserve Board, Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) jointly released Principles for Climate-Related Financial Risk Management for Large Financial Institutions.[12] The agencies acknowledge that failure to measure and mitigate climate-related financial risks can adversely impact the banks they supervise. The agencies write, "weaknesses in how a financial institution identifies, measures, monitors, and controls the physical and transition risks associated with a changing climate could adversely affect a financial institution's safety and soundness."[13] The agencies outline the need for banks to consider climate-related financial risks in business strategy, risk management, and strategic planning; incorporate climate-related financial risks when identifying and mitigating credit risk, liquidity risk, operational risk, and other types of financial and nonfinancial risks; and use scenario analysis to assess forward looking impacts on the institution resulting from climate risks. FSOC must acknowledge that the threats climate change poses to the largest banks are also present for the largest nonbank financial companies. Climate risks too "will migrate around the prudential constraints that apply to banks" without

[9] Graham Steele, "Confronting the 'Climate Lehman Moment': The Case for Macroprudential Climate Regulation," 30 Cornell J.L.& Pub. Pol'y 109 (2020), https://ssrn.com/abstract=3542840.
[10] Patrick Bolton et al., The green swan: Central banking and financial stability in the age of climate change, Bank for International Settlements, (January 2020), https://www.bis.org/publ/othp31.pdf.
[11] Brooklyn Montgomery and Monica Palmeira, Bluelining: Climate Financial Discrimination on the Horizon, The Greenlining Institute, (August 2023), https://greenlining.org/wp-content/uploads/2023/08/FINAL-GLI_Bluelining_report_2023.pdf; id.
[12] Principles for Climate-Related Financial Risk Management for Large Financial Institutions 88 FR 74183, https://www.govinfo.gov/content/pkg/FR-2023-10-30/pdf/2023-23844.pdf.
[13] Id at 74186.

equivalent regulatory and supervisory measures for nonbank financial companies. It is imperative that FSOC address the migration of climate risk with its designation authority.

## I. Climate change is destabilizing the insurance sector even as that sector is accelerating climate risk to the financial system.

The insurance industry is both exposed to and contributes to significant climate-related risks. The physical effects of climate change, including severe floods, wildfires, hurricanes, and other natural disasters, are straining insurance company balance sheets. Transition risks from underwriting, investment, and financing of fossil fuel projects threaten to leave insurers with stranded assets and financial exposure to declining industries. Despite these risks, insurance companies continue to underwrite projects that will make the climate crisis worse. Climate-related financial risks in the insurance industry also threaten other parts of the financial system, including banks, Government Sponsored Enterprises (GSEs), and investors through interconnected mortgage markets—as detailed in FSOC's 2023 Annual Report.[14] Failure to address these financial stability threats will also spill over into the real economy, collapsing property values, damaging local economies, and harming the economic well being of American families.

The physical effects of climate change on the insurance industry are visible across geographies. In addition to devastating impacts on life, livelihoods, and communities, climate disasters are causing unprecedented property damage. The United States had a record-breaking 23 natural disasters costing $1 billion or more in 2023, totalling over $57 billion in losses.[15] In response, property insurers are passing along costs to consumers or abandoning them entirely. On average, property insurance rates increased by over 11 percent in 2023.[16] In May 2023, State Farm announced that it would stop selling new property insurance policies to home and business owners in California.[17] In June 2023, Farmers announced it would stop selling auto, home, and umbrella policies in Florida.[18] The same month, AIG announced it would stop selling property insurance in 200 ZIP Codes across the United States, including in New York, Delaware, Florida, Colorado, Montana, Idaho, and Wyoming.[19] Recent *New York Times* reporting detailed the

[14] Annual Report 2023, Financial Stability Oversight Council, (December 14, 2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf.
[15] U.S. Billion-Dollar Weather and Climate Disasters, NOAA National Centers for Environmental Information, (2024), https://www.ncei.noaa.gov/access/billions/.
[16] Jason Woleben, US homeowners insurance rates jump by double digits in 2023, S&P Global, (January 25, 2024), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-homeowners-insurance-rates-jump-by-double-digits-in-2023-80057804.
[17] Michael R. Blood, California insurance market rattled by withdrawal of major companies, AP, (June 5, 2023), https://apnews.com/article/california-wildfire-insurance-e31bef0ed7eeddcde096a5b8f2c1768f.
[18] Brendan Farrington, Farmers pulls out of Florida property insurance despite efforts to stabilize the market, AP, (July 11, 2023), https://apnews.com/article/insurance-florida-business-desantis-a6c3a8e6127ecbf270099e87238ed47e.
[19] Jean Eaglesham, Home Insurers Curb New Policies in Risky Areas Nationally, The Wall Street Journal (June 8, 2023). https://www.wsj.com/articles/home-insurers-curb-new-policies-in-risky-areas-nationally-c93abac0.

financial troubles of insurers across the midwest including years of sustained losses in Iowa, Minnesota, and South Dakota, among other states.[20] The reporting found that in 2023, insurers lost money on home insurance coverage in 18 states, up from 12 in 2018 and eight in 2013.

The departure of major insurers is pushing homeowners into lower-quality private insurers or state insurance funds. In Florida, the gap left by traditional insurers is being filled by low quality private alternatives.[21] These insurers—now serving the most climate-vulnerable communities—have riskier liabilities, operate with higher leverage, and have more vulnerable and concentrated reinsurance relationships. In other states, the gap is being filled by public insurance options, with their own set of challenges and limitations. In Louisiana, the state's public insurance option, Louisiana Citizens Property Insurance Corporation (Louisiana Citizens), has been forced to fill the gaps left by the departure of traditional insurers. To address growing liabilities from climate disasters, Louisiana Citizens increased premiums by 63 percent in December 2023.[22] In March 2024, Louisiana Citizens borrowed $500 million to pay out claims to homeowners left without coverage after their private providers failed. Unlike private insurers, state insurance funds cannot leave climate-vulnerable communities—instead they pass costs along to consumers or turn to taxpayers as a backstop.

In addition to physical risks from climate disasters, insurance companies are exposed to transition risks from their failure to align investment and underwriting practices with the transition to a low-carbon economy. Through their aggregate $8.5 trillion investment portfolios, insurers finance fossil fuel companies and carbon-intensive industries that will be adversely affected by the energy transition.[23] Insurers who fail to transition their portfolios away from these firms will be left with financial exposure to insolvent firms or stranded assets. These investments will affect the ability of insurers to meet their liabilities and, in aggregate, will create a systemically undercapitalized insurance sector.[24] A disorderly transition away from these investments, due to postponing fossil fuel divestment or faulty assumptions that net zero goals can be achieved through carbon offsets and unproven technologies, has the potential to destabilize financial markets beyond insurance company portfolios. For insurers, climate risk

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[20] Christopher Flavelle, As Insurers Around the U.S. Bleed Cash From Climate Shocks, Homeowners Lose, The New York Times, (May 13, 2024), https://www.nytimes.com/interactive/2024/05/13/climate/insurance-homes-climate-change-weather.html.
[21] Parinitha Sastry et al., "When Insurers Exit: Climate Losses, Fragile Insurers, and Mortgage Markets," (2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4674279.
[22] Christopher Flavelle et al., Climate Shocks Are Making Parts of America Uninsurable. It Just Got Worse., The New York Times, (May 31, 2023), https://www.nytimes.com/2023/05/31/climate/climate-change-insurance-wildfires-california.html.
[23] Michele Wong, U.S. Insurance Industry's Cash and Invested Assets Rise to $8.5 Trillion at Year-End 2023, National Association of Insurance Commissioners, (May 8, 2024), https://content.naic.org/sites/default/files/capital-markets-special-reports-asset-mix-ye2023.pdf.
[24] Hyeyoon Jung et al., Measuring the Climate Risk Exposure of Insurers, Federal Reserve Bank of New York, (July 2023), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1066.pdf.

acts as a double-edged sword—physical risks increase insurer liabilities, while transition risks reduce the ability of insurers to meet those liabilities.

Despite the risks climate change poses to the business model of insurance firms, insurers continue to underwrite projects and activities that worsen the climate crisis. The Insure Our Future (IOF) coalition estimates that the largest U.S. insurers, including Chubb, W.R. Berkley, and AIG each collect upward of $500 million in annual premiums from fossil fuel companies.[25] In many cases, the insurance companies enabling fossil fuel expansion are the same ones raising rates or withdrawing coverage from homeowners. In doing so, insurance firms seek to earn short-term profits in one business line while undermining the long-term viability of numerous other business lines. Beyond the impacts on their own solvency and longevity, insurance company underwriting of fossil fuel projects introduces profound and growing risk into the financial system that other institutions and the economy as a whole will be forced to bear.

## II. AIG is a leading candidate for designation as a systemically important nonbank.

Through multiple channels, AIG is creating unsustainable risks for itself and for the financial system. FSOC's 2023 guidance authorizes designation of a nonbank financial company if material financial distress at the company or the company's nature, scope, size, scale, concentration, interconnectedness, or mix of activities could pose a threat to financial stability.[26] The corresponding analytical framework details the vulnerabilities FSOC intends to consider when evaluating a firm for designation and the transmission channels through which these vulnerabilities can pose threats to financial stability.[27] This letter examines the following vulnerabilities as they relate to AIG's suitability for designation: (a) engagement in destabilizing activities; (b) inadequate risk management; (c) financial interconnectedness; (d) liquidity risk and maturity mismatch; and (e) complexity and opacity.

In examining AIG's suitability for designation, FSOC should also consider the risks AIG has taken on in the absence of regulatory scrutiny, following its dedesignation in 2017. FSOC designated AIG in 2013, citing AIG's "size and interconnectedness, certain characteristics of its liabilities and products, the potential effects of a rapid liquidation of its assets, potential challenges with resolvability, as well as other factors."[28] In 2017, FSOC rescinded its designation, citing actions AIG took to reduce its risk since 2013, including "reduc[ing] total

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[25] Insure our Future, Insurers withdraw cover for climate risks while backing increased fossil fuel production, industry must act to support 1.5°C climate target after 50 years of failure, (November 9, 2023), https://global.insure-our-future.com/scorecard-2023/.
[26] Guidance on Nonbank Financial Company Determinations 12 CFR 1310.
[27] Analytic Framework for Financial Stability Risk Identification, Assessment, and Response 88 FR 78026.
[28] Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc., Financial Stability Oversight Council, (July 8, 2013), https://home.treasury.gov/system/files/261/American%20International%20Group%2C%20Inc.pdf.

debt outstanding, short-term debt, derivatives, securities lending, repurchase agreements, and total assets."[29] In addition to examining AIG's vulnerabilities against the 2023 analytical framework, FSOC should examine AIG against the risk factors it highlighted as justification for its dedesignation. For example, in 2013, AIG had $549 billion in assets compared to $500 billion in assets in 2017.[30] As of the end of 2023, AIG's assets had grown to $539 billion.[31] In 2013, AIG had $215 billion of total derivatives exposure compared to $165 billion in 2017.[32] As of year-end 2023, AIG's total derivative exposure had grown to $184 billion.[33] AIG is again adding risk, in some cases, along the very dimensions that necessitated its designation in 2013.

*A. Engagement in destabilizing activities*

The 2008 financial crisis revealed that AIG was engaged in activities that destabilized itself and the financial system writ large. In the lead up to the crisis, AIG was an active player in credit default swap (CDS) markets, taking large one-way positions on collateralized debt obligations, which left the firm exposed to low-quality residential and commercial mortgages.[34] AIG was also heavily involved in securities lending—lending out large portions of its portfolio with insufficient liquidity to accommodate counterparty unwinds of these transactions. AIG is no longer imperiled by these particular activities. The financial crisis functionally ended AIG's Financial Products Corporation subsidiary through which it was actively engaged in CDS markets, and AIG's securities lending business has shrunk to a fraction of its former size.[35]

But AIG has not abandoned its role as an outsized risk taker. It has simply swapped one set of risky activities for another. Instead of threatening its own financial viability and creating risks to the financial system through CDS exposure and securities lending, AIG is creating risks for its own business model and threatening financial stability through its underwriting and investment

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[29] Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding American International Group, Inc. (AIG), Financial Stability Oversight Council, (September 29, 2017), https://home.treasury.gov/system/files/261/American%20International%20Group%2C%20Inc.%20%28Rescission%29.pdf.

[30] Gregg Gelzinis, Deregulating AIG Was a Mistake, Center for American Progress, (October 11, 2017), https://www.americanprogress.org/article/deregulating-aig-mistake/.

[31] American International Group, Inc., Annual Report (2023), https://www.aig.com/content/dam/aig/america-canada/us/documents/investor-relations/annual-report/aig-2023-annual-report.pdf.

[32] Gregg Gelzinis, Deregulating AIG Was a Mistake, Center for American Progress, (October 11, 2017), https://www.americanprogress.org/article/deregulating-aig-mistake/.

[33] American International Group, Inc., Annual Report (2023), https://www.aig.com/content/dam/aig/america-canada/us/documents/investor-relations/annual-report/aig-2023-annual-report.pdf.

[34] Robert McDonald and Anna Paulson, What Went Wrong at AIG?, Kellogg School of Management, (August 3, 2015), https://insight.kellogg.northwestern.edu/article/what-went-wrong-at-aig.

[35] *Id*; American International Group, Inc., Annual Report (2023), https://www.aig.com/content/dam/aig/america-canada/us/documents/investor-relations/annual-report/aig-2023-annual-report.pdf.

in fossil fuel projects and assets. At present, AIG is taking an irrational bet on the future stability of its business by insuring companies that face stranded asset risks, fueling the climate disasters that directly challenge its bottom line and those of other insurers, and investing in emissions-intensive firms and industries through its investment portfolio—creating transition risk for itself and physical risk for financial markets more broadly.

Through its underwriting activities, AIG is facilitating the continued operation and expansion of the fossil fuel industry. IOF estimates that AIG receives approximately $550 million in annual premiums from insuring fossil fuel projects.[36] AIG is the largest insurer of U.S. coal, the most carbon-intensive source of energy and the largest contributor of carbon dioxide emissions, insuring at least 30 percent of U.S. production.[37] AIG no longer sells property insurance in the state of Louisiana due to hurricane risk, but AIG subsidiaries underwrite fossil fuel projects in the state, including liquified natural gas terminals built to export gas abroad.[38] In recent years, AIG has insured some of the most controversial fossil fuel infrastructure projects, including the Trans Mountain Pipeline, which is designed to transport up to 590,000 barrels per day of carbon-intensive tar sands.[39] When Chubb dropped insurance coverage for the Rio Grande LNG project earlier, AIG stepped in to insure the project, despite the project's climate impacts and organized opposition from community members.[40]

AIG's continued underwriting of fossil fuel projects is incompatible with science-backed climate goals. The Intergovernmental Panel on Climate Change (IPCC) warns that maintaining a 1.5°C warming pathway requires a rapid and significant phase down of fossil fuels this decade.[41] While launching a Senate Budget Committee investigation on insurance company climate risk, Chair Whitehouse wrote,

> Any new fossil fuel expansion is incompatible with our climate goals and economic stability. By underwriting and investing in new and expanded fossil fuel

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[36] Insure our Future, Insurers withdraw cover for climate risks while backing increased fossil fuel production, industry must act to support 1.5°C climate target after 50 years of failure, (November 9, 2023), https://global.insure-our-future.com/scorecard-2023/.

[37] Covering Coal: The Top Insurers of U.S. Coal Mining, Public Citizen and Insure our Future, (September 28, 2023), https://www.citizen.org/article/covering-coal/.

[38] Michael Finch II, Here are the Louisiana insurers that have gone broke or left the state amid deepening crisis, The Times-Picayune, (September 222, 2022), https://www.nola.com/news/business/here-are-the-louisiana-insurers-that-have-gone-broke-or-left-the-state-amid-deepening/article_c7f077b4-3e98-11ed-86c9-f7f11037202f.html; Risk Exposure: The Insurers Secretly Backing the Methane Gas Boom in the US Gulf South, Public Citizen, (February 21, 2024), https://www.citizen.org/article/insurers-secretly-back-lng-boom-in-the-gulf-coast/.

[39] Public Citizen, Groups Call on AIG to Cut Ties with Trans Mountain Pipeline, (April 28, 2022), https://www.citizen.org/news/groups-call-on-aig-to-cut-ties-with-trans-mountain-pipeline/.

[40] Chubb Drops Rio Grande LNG Insurance, Insure Our Future, (August 6, 2024), https://us.insure-our-future.com/chubb-drops-rio-grande-lng-insurance/.

[41] Hoesung Lee et al., Climate Change 2023 Synthesis Report: Summary for Policymakers, Intergovernmental Panel on Climate Change, (March 20, 2023), https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf.

> projects, U.S. insurers are helping Big Oil bring us closer to the worst runaway climate scenarios, which threaten lives, livelihoods, and the federal budget.[42]

AIG is also exacerbating the climate crisis through its investment portfolio. AIG holds an estimated $24.2 billion in fossil fuel assets—investments that facilitate further exploration, extraction, and use of fossil fuels, increasing greenhouse gas emissions and polluting communities.[43] According to AIG's 2023 ESG report, the company's internally managed corporate bond holdings align to a 2.2°C temperature increase, a warming pathway significantly above the 1.5°C limit on temperature increase needed to meet climate goals.[44] The Network for Greening the Financial System (NGFS) has created scenarios to help financial institutions understand their risks in a variety of climate scenarios. The Current Policies scenario, the scenario that incorporates the most physical risk, assumes only 2 degrees of warming by 2050. This scenario predicts a ten percent decline in labor productivity, a near 50 percent increase in hurricane damage in the U.S, and GDP loss due to severe weather events.[45] As of its most recent ESG report, AIG's corporate bond holdings align with a warming pathway even more severe than this NGFS scenario, signaling even more climate harms and adverse economic impacts. Moreover, the corporate bond holdings AIG reports in in its ESG report do not comprise its full corporate bond holdings. Investments managed externally, including by Blackstone and BlackRock, are not included in the emissions contributions of AIG's investment portfolio.

### *B. Inadequate risk management*

While AIG contributes to the climate crisis through both its underwriting activities and its investments, the company has failed to mitigate the risks the climate crisis will have on its own solvency and long-term viability. To date, AIG has failed to publicly engage in transition planning—charting out a course to move its underwriting activities away from fossil fuels and into business lines aligned with a net-zero economy. Even as AIG has downsized and spun off several of its business lines, it remains committed to fossil fuel underwriting. AIG promotes Energy Property Insurance for oil, petrochemical, power generation, minings, and more as one of its five major corporate specialized risk offerings.[46] Continued engagement in fossil fuel underwriting with no credible plan to move its business model away from these activities exposes the firm to significant transition risk. AIG cannot long expect to continue to generate

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[42] United States Senate Committe on the Budget, Budget Committee Launches Investigation into Major Insurance Companies' Climate Risk Evaluation, Fossil Fuel Support, (June 9, 2023), https://www.budget.senate.gov/chairman/newsroom/press/budget-committee-launches-investigation-into-major-insurance-companies-climate-risk-evaluation-fossil-fuel-support-.

[43] Insurance Giant AIG Continues Underwriting and Investment in Fossil Fuels at Alarming Rates, Public Citizen, (November 10, 2023), https://www.citizen.org/news/aig-2023-fossil-fuel-scorecard/.

[44] 2023 Sustainability Report, American International Group, Inc., (date), https://www.aig.com/content/dam/aig/america-canada/us/documents/about-us/report/aig-sustainability-report-2023.pdf.

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

[46] Energy Property Insurance, AIG, https://www.aig.com/home/risk-solutions/business/specialty-risks/energy/energy-property.

revenue from underwriting fossil fuel projects in a world moving away from them. Concentrating revenue in sectors that by necessity will shrink in coming years, especially those that inherently increase strain on the company's finances, is a poor risk management strategy.

Similarly, AIG has failed to engage in credible transition planning to align its investment portfolio with science-based targets and commitments under the Paris Climate Agreement. AIG has failed to address how it will wind down its $24.2 billion of fossil fuel assets without creating market disruptions or taking losses. Investment portfolio transition planning is essential for insurance firms, as they frequently pursue similar investment strategies. Correlated investments can create concentrated losses for the industry as firms rush to unwind fossil fuel portfolios, in turn making portfolios even harder to unwind.[47] In discussions of transition risk, significant attention is paid to stranded asset risk, and for good reason. But assets don't need to become obsolete to create transition risk for insurance firms. Rating downgrades of fossil fuel assets can create a correlated dash to the exit for insurance firms whose capital adequacy framework strongly incentivizes firms to hold investment grade securities.[48] As such, assumptions that transition risks won't materialize for years or even decades are misguided. Fossil fuel companies don't need to be insolvent to threaten insurance company portfolios and insurance firms' ability to generate sufficient returns to meet liabilities.

To date, AIG's primary strategy to address the physical risks of climate change has been to transfer them back to the consumer by increasing rates and withdrawing coverage. AIG is not alone in this practice. A reliance on one-year contracts allows insurers to drop customers easily year to year. But this practice has its limits. AIG and other insurers can erode their market share only so much before they sacrifice their long-term viability; destroying and retreating from one's own markets is an inherently perilous practice. Likewise, fossil fuel insurers who point to one year contracts as the solution to transition risk—citing their ability to drop fossil fuel projects on a dime—replicate the same problem. Ultimately, for insurers, shedding liabilities also means shedding revenue.

Risk transfer strategies also do nothing to reduce climate risk in the financial system. Instead of mitigating risks, insurers are treating climate risks like a game of hot potato, rushing to pass risks back to customers, low quality insurers, or state insurance funds before the next climate disaster. This practice should be a primary concern for FSOC. Attempts by AIG and other insurers to insulate their own balance sheet from climate disasters are not viable strategies to mitigate climate risk to themselves or the financial system.

[47] Natahn Foley-Fisher et al, Assessing the size of the risks posed by life insurers' nontraditional liabilities, Federal Reserve Board, (May 21, 2019), https://www.federalreserve.gov/econres/notes/feds-notes/assessing-the-size-of-the-risks-posed-by-life-insurers-nontraditional-liabilities-20190521.html.
[48] Vikram Nanda et al., Investment Commonality across Insurance Companies: Fire Sale Risk and Corporate Yield Spreads, Board of Governors of the Federal Reserve System, (2017), https://www.federalreserve.gov/econres/feds/files/2017069pap.pdf.

Insurers also do not transfer risk equally across communities. Bluelining, or the practice of limiting credit creation and investment in climate-vulnerable areas, often leads to financial exclusion for low income communities and communities of color.[49] Due to a history of systemic exclusion, including redlining, low income communities and communities of color are overrepresented in climate-vulnerable areas and are disproportionately subjected to risk transfer strategies by insurance companies, including higher premiums or the loss of coverage. Bluelining can exacerbate existing inequalities, creating further financial exclusion for communities that already face systemic barriers to credit access and homeownership.

### *C. Financial interconnectedness*

AIG and other insurance companies are deeply intertwined with other financial institutions. As such, the impacts of climate change on insurance cost, quality, and availability are not confined to insurers and their customers. Banks, GSEs, and other financial institutions are affected by the climate emergency looming in insurance markets due to their interconnectivity with insurance firms and their reliance on insurance to hedge risk. Banks, for example, require mortgage borrowers to purchase homeowners insurance as lack of insurance can impair a borrower's ability to make mortgage payments in the event of a disaster. The proliferation of low-quality insurers is introducing risk into the system. Although banks continue to originate mortgages to homeowners insured by low-quality providers, banks are increasingly uncomfortable holding this risk on their own balance sheet. In an effort to reduce exposure, banks are selling large portions of their mortgages covered by these insurers to GSEs.[50] GSE's are, in turn, transferring these risks to other entities.[51] Low-quality credit rating agencies have emerged to rubber stamp these insurers, making the mortgages on homes they insure eligible for purchase by GSEs, who require mortgages be insured by highly rated providers. The lack of insurance availability from traditional providers adds risk to the system, and the ability of banks to originate risk that is distributed throughout the financial system leaves these risks undercounted by regulators.

Climate disasters are the spark that can turn latent insurance-related risks in mortgage markets into full blown crises. Paying out claims after a disaster can put financial strain on insurers and in some cases lead to insolvency. When insurer insolvency reduces or delays claims paid to homeowners, homeowners may be unable to pay their mortgage, increasing defaults for mortgage lenders. For these lenders, climate disasters can also increase losses given default as

[49] Brooklyn Montgomery and Monica Palmeira, Bluelining: Climate Financial Discrimination on the Horizon, The Greenlining Institute, (August 2023), https://greenlining.org/wp-content/uploads/2023/08/FINAL-GLI_Bluelining_report_2023.pdf.
[50] Parinitha Sastry et al., "When Insurers Exit: Climate Losses, Fragile Insurers, and Mortgage Markets," (2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4674279.
[51] Pedro Gete et al., "Climate risk in mortgage markets: Evidence from Hurricanes Harvey and Irma," 52 Real Estate Economics 660, (2024), https://doi.org/10.1111/1540-6229.12477.

the disaster has reduced or destroyed the value of the underlying mortgage collateral.[52] These events can impair the balance sheet of the mortgage lender or the GSE who has purchased the mortgage. As climate disasters become more frequent, more severe, and affect larger geographies, mortgage losses have the potential to affect the solvency of lenders, GSEs, and investors. To manage climate risks, lenders may end mortgage underwriting in climate-vulnerable areas altogether, leaving communities without access to homeownership. As the *New York Times* summarized in recent reporting on the insurance crisis, "Without insurance, banks won't issue a mortgage; without a mortgage, most people can't buy a home. With fewer buyers, real estate values are likely to decline, along with property tax revenues, leaving communities with less money for schools, police and other basic services."[53]

### *D. Liquidity risk and maturity mismatch*

Central to the financial viability of insurance firms is asset-liability management. The solvency of insurers rests on the ability to collect more in premiums and investment returns than is required to pay out in claims, and sufficient liquidity is required to meet claims when they arise. Solvency and liquidity are, of course, deeply intertwined. Fire sales from insufficient liquidity can erode the value of insurance company investment portfolios, and the failure to collect sufficient premiums to meet future liabilities can encourage increased risk taking and illiquidity. The climate crisis is creating significant asset-liability management challenges for insurers. Over the last decade, frequent and severe weather events have caused insurers, in aggregate, to pay out more in claims than they received in premiums.[54] While investment returns have succeeded in plugging this gap for now, it reflects a troubling trend, set to worsen as the costs of climate disasters grow.

The persistent mismatch between premiums and claims creates perverse incentives for insurance companies to take added risk in their investment portfolios, including added liquidity risk. Due to a variety of factors, including an extended period of low interest rates and higher than expected claims, insurance companies are moving large portions of their portfolios from investments in public debt securities to private credit in search of higher returns.[55] In 2021, AIG entered into a long-term investment management relationship with the private investment giant, Blackstone. In 2021, Blackstone began managing $50 billion of AIG's investment portfolio, with a commitment

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[52] Parinitha Sastry et al., "When Insurers Exit: Climate Losses, Fragile Insurers, and Mortgage Markets," (2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4674279.
[53] Christopher Flavelle, As Insurers Around the U.S. Bleed Cash From Climate Shocks, Homeowners Lose, The New York Times, (May 13, 2024), https://www.nytimes.com/interactive/2024/05/13/climate/insurance-homes-climate-change-weather.html.
[54] Christopher Flavelle, As Insurers Around the U.S. Bleed Cash From Climate Shocks, Homeowners Lose, The New York Times, (May 13, 2024), https://www.nytimes.com/interactive/2024/05/13/climate/insurance-homes-climate-change-weather.html.
[55] John Foley, Private-asset binge exposes insurance to new risks, Reuters, (December 1, 2023), https://www.reuters.com/breakingviews/private-asset-binge-exposes-insurance-new-risks-2023-11-30/.

to increase that figure to $92.5 billion by the third quarter of 2027.[56] AIG's collective investment in alternative assets—private debt, equity, and hedge funds—totaled $68 billion as of December 31, 2023. AIG acknowledges that these securities are less liquid than others in its portfolio and that "if it became necessary to sell such assets in a stressed market environment, the prices achieved in any sale of such securities may be lower than their carrying value, which could cause a material adverse effect on our business, financial condition, results of operations and cash flows."[57]

While Blackstone manages a primarily investment-grade portfolio for AIG, these private credit holdings carry more risk than their similarly rated public counterparts and have more uncertain return profiles in economic downturns. Unlike corporate bonds, private credit investments typically require long-term capital lockups and constraints on investor redemptions.[58] Dean Ungar, a vice president at Moody's writes, "Although structuring and investing in more senior positions provides protection to creditors, these investments have lower liquidity and transparency than corporate bonds, and some have not been tested in a prolonged economic downturn."[59] In moving from public debt securities to private credit, AIG is reducing its liquidity profile at a time it can ill afford to do so. The current pace of climate disasters necessitates insurance companies becoming more liquid, rather than less, to meet customer claims. Nevertheless, in this context AIG is ramping up its exposure to illiquid private investments.

### *E. Complexity and opacity*

At present, fully assessing AIG's climate-related risk and that of other insurers is challenging due to the opacity of the insurance industry and the decentralized nature of insurance regulation. Designation of AIG and other large U.S. insurers would give the Federal Reserve access to timely and ongoing information about insurance company activities, such as plans to change or discontinue insurance offering in certain geographies or take on new climate-intensive projects. At present, federal regulators are limited to information made public by insurers or collected occasionally by state insurance regulators. This lack of transparency is itself a financial stability risk.

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[56] American International Group, Inc., Annual Report (2023), https://www.aig.com/content/dam/aig/america-canada/us/documents/investor-relations/annual-report/aig-2023-annual-report.pdf.

[57] *id* at 25.

[58] Charles Cohen et al. Fast-Growing $2 Trillion Private Credit Market Warrants Closer Watch, International Monetary Fund, (April 8, 2024), https://www.imf.org/en/Blogs/Articles/2024/04/08/fast-growing-USD2-trillion-private-credit-market-warrants-closer-watch.

[59] Michael Thrasher, Insurance Companies Binged on Private Credit. Moody's Is a Little Worried About It., Institutional Investor, (October 5, 2023), https://www.institutionalinvestor.com/article/2ca5eps7dgt2eeurp6gw0/portfolio/insurance-companies-binged-on-private-credit-moodys-is-a-little-worried-about-it.

The insurance industry is significantly more opaque than other sectors of the financial system. While federal regulators have access to a timely, national source of transaction-level data on loans and mortgage origination from banks and mortgage lenders, no such mandatory data exists for homeowner insurance providers. This leaves insurers, including the largest and most complex, significantly under-scrutinized by regulators. In the Federal Reserve's pilot climate scenario analysis, conducted with the largest six U.S. banks, participants highlighted gaps in property insurance data as a major challenge. The Federal Reserve noted that "[a]ll participants reported data gaps related to insurance, including insurance coverage details, replacement cost value, and deductibles."[60] Insurers are also not required to disclose the fossil fuel projects they underwrite. AIG, for example, is not required to disclose the numerous LNG terminals it underwrites in the Gulf South, even as those terminals expose investors to transition risk and surrounding communities to pollution and safety events like spills and explosions.

To address the climate data gaps in property insurance markets, the Federal Insurance Office (FIO) and the National Association of Insurance Commissioners (NAIC) are pursuing a Climate-Related Financial Risk Data Collection effort from large writers of homeowners insurance.[61] FSOC has highlighted this data collection as a priority to inform its work addressing the growing risks at the nexus of climate change, property insurance, and housing. In its 2023 Annual Report, FSOC recommends, "state and federal agencies continue to coordinate to identify, prioritize, and procure data necessary for monitoring climate-related financial risks" including through FIO's proposed data collection.[62] These data collection efforts are essential to address opacity in the insurance industry, but their voluntary nature for states limits their usefulness to FSOC and financial regulators. To date, ten states have opted out of FIO's data collection in full or in part, including several states at the center of the insurance crisis such as Louisiana.[63] These opt-outs limit the ability of FSOC to fully assess the financial stability threats present in the insurance industry and mitigate these risks.

As FSOC considers the risks AIG and other insurers pose to financial stability, it must consider the complexity of measuring and managing risk due to insurance company dependence on reinsurance and the vulnerabilities reinsurers have to the climate crisis. In its 2023 Annual Report, AIG cited "increases in costs associated with third-party reinsurance, or decreased ability to obtain reinsurance on acceptable terms" as a key market condition affecting profitability, liquidity, and business operations.[64] The Annual Report also highlighted that "reinsurance is

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[60] Pilot Climate Scenario Analysis Exercise, Board of Governors of the Federal Reserve System, (May 2024), https://www.federalreserve.gov/publications/files/csa-exercise-summary-20240509.pdf.

[61] Insurance Office Climate-Related Financial Risk Data Collection for U.S. Homeowners Multi-Peril Underwriting Data 88 FR 75380

[62] Annual Report 2023, Financial Stability Oversight Council, (December 14, 2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf.

[63] Emily Flitter, National Plan to Look Into Homeowners Insurers Hits a Hurdle, The New York Times, (March 21, 2024), https://www.nytimes.com/2024/03/21/business/naic-homeowners-insurers-states-hurdle.html.

[64] American International Group, Inc., Annual Report (2023),

typically more difficult or costly to obtain after a year or consecutive years with a large number of major catastrophes, the likelihood of which may be exacerbated by climate change."[65] Reinsurers too are facing losses as a result of physical climate risk, paying out claims to primary companies after climate disasters. In response, reinsurers are raising rates, limiting coverage, and exiting some markets entirely to improve profitability.[66] AIG and other insurers can no longer depend as heavily on the availability and affordability of reinsurance to hedge their risks. Unexpected reinsurance price increases or the loss of reinsurance altogether creates added financial vulnerabilities for insurers.

## Conclusion

To fulfill its vital mandate, FSOC must use its full authority to address the growing financial stability threats present in the insurance industry, including by moving to designate AIG and other large U.S. insurers contributing to and impacted by the climate crisis as systemically important. Failure to address climate-related risks in the insurance industry will threaten numerous financial sectors and markets, creating a cascade of risks that will negatively impact property values, tax revenues, and local economies. The harshest of these impacts will fall disproportionately on the most vulnerable, including low income communities and communities of color. As a critical first step in meeting the emerging challenges in the insurance sector, FSOC should examine AIG's financial vulnerabilities, including its engagement in destabilizing activities, inadequate risk management, interconnectedness with other financial institutions, liquidity risk, and the risks created by its complexity and opacity to determine suitability for designation. Inaction today will become increasingly unjustifiable in years to come. We urge you to act decisively now with your existing authorities to safeguard the stability of our financial system.

Thank you for your attention to this important matter. For questions, please contact Elyse Schupak at eschupak@citizen.org.

Sincerely,
Public Citizen

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https://www.aig.com/content/dam/aig/america-canada/us/documents/investor-relations/annual-report/aig-2023-annual-report.pdf, at 17.

[65] *Id* at 20.

[66] Reinsurers defend against rising tide of natural catastrophe losses, for now, Moody's, (January 10, 2023), https://www.moodys.com/web/en/us/about/insights/data-stories/reinsurers-mitigate-lower-profits.html.