Remarks by Secretary Janet L. Yellen at the Open Session of the Meeting of the Financial Stability Oversight Council

October 21, 2021

Today is an important day for FSOC. We are publishing our report on climate-related financial risk, and, for the first time, FSOC is recognizing that climate change is an emerging and increasing threat to U.S. financial stability. This report puts climate change squarely at the forefront of the agenda of its member agencies and is a critical first step forward in addressing the threat of climate change. It will by no means be the end of this work.

I think it's worth taking a few minutes to place this body of work into the proper historical context. This Council, as we well know, was established in the aftermath of the 2008 financial crisis with the goal of preventing such a crisis from ever occurring again. Over the past decade, we have made meaningful progress, building the oversight infrastructure to protect against another such event. But as the maxim goes, we cannot simply "fight the last war." We must look forward – that is our responsibility under the Dodd-Frank Act, which gave this Council the duty to respond to emerging threats to the stability of the United States financial system.

Today, we are recognizing a unique, existential risk for the planet that will affect every aspect of our lives and the lives of our children—including through effects on the financial sector. It does not require a vivid imagination to see how climate change could threaten the financial system. As climate change intensifies, more frequent and severe climate-related events—wildfires, tropical storms, and flooding, for example—could trigger declines in asset values and economic activity that could cascade through the financial system, especially if such risks are not properly measured and mitigated. Moreover, the economic adjustments required to address climate change are large and need to begin soon, including through smart government policies to facilitate the transition to a net-zero economy. If such policies are delayed and later implemented in an abrupt, disorderly fashion, a rapid revision of perceptions could lead to sudden and dramatic effects on economic activity and asset values. The longer we wait to address the underlying causes of climate change, the greater this risk.

The responsibility of this Council is to ensure the resilience of the financial system to the future impacts of climate change. We have identified climate change as an emerging threat to the financial stability of the United States. But we must be crystal clear that an emerging threat is not the same as a hypothetical one, and it would be foolish to confuse the two.

It is challenging to predict the future impacts of climate change precisely, but we know that climate change has already started causing an array of economic harms, and failure to address climate-related financial risks will only allow them to grow larger.

Indeed, the costs of climate change are increasingly impacting household's expenses, income, and homes as well as corporate balance sheets. As we were drafting this report, Hurricane Ida tore through the middle of the country, displacing thousands of people in small, rural towns and leaving New Orleans without power for an extended period. And this was unfortunately only one example of extreme weather events, almost surely tied to climate change, that we witnessed over the few months during which we drafted the report. We also saw a record heatwave in the Pacific Northwest. Wildfires tore across the American West to a degree unimaginable to many of us just a few years ago.

The events of this summer are an all-too-unfortunate reminder of why today's report is critical. The report makes recommendations for how Council member agencies can more effectively respond to these particular climate-related risks – what we term "the physical risks" – as well as the transition risks of the necessary shift to a lower-carbon economy. In total, the report contains over 30 specific recommendations, but generally speaking, they fall into four main areas:

- First: Assess climate-related financial risks to financial stability, including through scenario analysis, and evaluate whether revised or new regulations or guidance is necessary to properly account for these risks. The future is inherently uncertain, and scenario analysis is one promising tool that has been used internationally to assess these risks. At the same time, regulators need to consider whether existing guidance should be adjusted—or new guidance or regulations considered—to ensure proper management of climate-related financial risks. We cannot wait for perfect assessments or data to take action.

- Second: Promote enhanced climate-related risk disclosures. In a well-functioning and transparent market, we might see investors and firms naturally transitioning away from investments that pose excessive climate-related risks if those risks are mispriced. Often, the reason they aren't doing so is because they do not have the relevant information. Enhanced climate disclosures can address that information failure, enabling market participants to make decisions with more complete data.
- Third: Enhance climate-related data to allow better risk measurement by regulators and the private sector. The climate is changing, and some risks may manifest in new and unprecedented ways. We need to fill data gaps and better integrate climate, economic, and financial data to improve our understanding of and exposure to climate risks.
- Fourth: Build capacity. Analyzing all this information and coordinating the response among the Council's member agencies requires more resources. For that reason, the report recommends establishing a staff-level Climate-related Financial Risk Committee within FSOC. That committee will serve as an organizing body for FSOC agencies to share information and collaborate on this issue.

It's important to note that this report is not exhaustive. Nor is it the final word from the Council on this urgent priority. Instead, it is just a first step. As our capacity to respond to climate change increases – as our base of information expands and our reservoir of expertise deepens – we expect to formulate new strategies to address this emerging threat to financial stability.

Finally, I should stress that our most financially stable future is our most environmentally sustainable future, one where we've transitioned to a low-carbon economy. Many institutions and individuals – in and out of government – are tasked with facilitating that future. I would add, on a personal note, that I consider myself one of them: As Chair of this Council, as Secretary of the Treasury, and as a resident of this planet, I believe it is my task to hand down a livable and financially prosperous world to future generations. I know many of you feel the same. And I am hopeful that future generations will favorably judge our efforts.

Thank you.