Joint Letter: Prevent a ‘Climate Lehman Moment’

The collapse of Lehman Brothers triggered the last global financial crisis. There’s a new threat on the horizon, yet a simple way to step back from the point of no return.

to be sent from Brussels on 27 October 2021

Dear **(Recipient), (see below the list of recipients)**

Right now, we run the risk of another financial crisis, this time caused by climate change. Climate scientists from around the world warn that global warming is dangerously close to being out of control.[1] There is global recognition that this crisis also threatens the stability of our financial system.[2] And yet, despite net-zero emission pledges, **most banks and insurers remain on a self-destructive path.[3] They perpetuate the risks of climate change by financing and insuring fossil fuel-related activities.[4]**

As the climate meltdown unfolds, financial institutions will face losses stemming from disruptive weather events, which intensify and increase in frequency. Examples abound, such as recent heavy flooding in Europe, a terrible instance of multi-billion dollar damages from catastrophic, climate change-related forces.[5] Such events are leading to huge unexpected payouts by insurance companies and to the destruction of assets and business operations that banks and insurers are exposed to. Moreover, frequent natural disasters are driving up premiums for insurance coverage, leaving citizens, businesses and financial institutions exposed to climate change related risks.[6]

Furthermore, with the transition to a low-carbon economy, fossil fuel assets of banks and insurers will rapidly diminish in value or become entirely worthless. This will lead to massive losses for financial institutions, which could result in them requiring bailouts, where the public is the one to pay.

The truth is: we already have six times more fossil fuel reserves than we can afford to burn.[7] **Even the International Energy Agency (IEA) recently stated that if we want to meet the goals of the Paris Agreement, investments in new fossil fuels must stop immediately**.[8] This was recently echoed by United Nations Secretary-General Antonio Guterres.[9]

Therefore, any financing and insurance of new fossil fuel exploration and production is:

- **extremely risky, as new fossil fuels will lose their value.**
- **at odds with the Paris Agreement**.

An immediately feasible solution[10]

If a bank or insurer still wants to venture into an activity that explores and produces ***new fossil fuels***, they should be constrained to take the entire risk of funding this activity on their shoulders. Policymakers should introduce a **One-for-One rule for stability**: Every euro/dollar/pound etc. of financing provided must be matched by one currency unit of institutions´ own funds, to be held liable. Their own funds should be sufficient to fully absorb losses without exposing depositors, policyholders and ultimately tax payers and society to the losses they will inevitably incur.[11]

Capital requirements for ***existing*** fossil fuel financing should also be increased, albeit to a lesser extent than that for new fossil fuels. This will allow the financing for existing fossil fuels to be phased out gradually, without jeopardising financial stability.

Such prudential regulation would:

- protect those who entrust their money with financial institutions, and prevent a potential financial crisis
- protect taxpayers, whose funds would otherwise be used in a bail-out scenario
- mitigate the risks of climate change in the first place, as the incentive in current prudential rules to finance fossil fuels, which equates to a subsidy, would be removed.

Capital regulations for banks and insurers already mandate higher capital charges for high risk exposures. All we need to do is to make sure that fossil fuel exposures are recognised as high-risk within the existing rules.

This idea has been endorsed by a panel of 50 sustainable finance experts from across academia, civil society, commercial banks, central banks and the investor community.[12]

At the moment, financing and insuring coal, oil and gas projects remains artificially cheap. The capital levels that banks and insurers must maintain to cover potential future losses does not match the risks of these exposures. The lack of action so far is grounded in a paradox: Policy-makers and supervisors recognise the near impossibility of modelling climate-related risks due to the radical uncertainty of climate events.[13] But they say they need such modelling to be done before intervening. By waiting for these impossible calculations, **financial regulators extend an indirect subsidy to climate change-causing industries.**

We cannot wait. The climate clock is ticking. Other interventions on their own will not have the impact we need to prevent irreversible devastating impacts of climate change on the financial system.

(Insert specific ask from each recipient- see below)

Yours Sincerely,

Finance Watch

+ Civil society organisations + Leading thinkers + select progressive voices from financial institutions

Annotations

1. IPCC (2021) *Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change*
2. See for example: Villeroy de Galhau, F. (2020) *The green swan*, Foreword; LAGARDE, C. (2020) *It is difficult to disagree that climate change is a threat to financial stability*; and CARNEY, M (2015) *Breaking the tragedy of the horizon – climate change and financial stability*.
3. Nagrawala et al (2021) *Countdown to COP26* and *Insuring Disaster*, ShareAction
4. The world's largest banks have provided $3.8 trillion to the fossil fuel industry since the Paris Agreement. For insurers, data *shows* that the largest U.S. and European insurers currently have invested around $600 billion in fossil fuels and the international insurance market for oil and gas totalled premiums of $17.3 billion in 2018.
5. Sheehan, M. (2021) *Europe floods largely uninsured, despite multi-billion industry loss: Aon*, Reinsurance News.
6. German Insurance Association (GDV) (2021) data, for example, *shows* that 54% of properties in Germany lack any insurance coverage against weather phenomena.
7. Carbon Tracker (2018) data *shows* that existing fossil fuel reserves amount to 2910 gigatonnes of carbon dioxide emissions, whereas the calculated carbon budget of our planet is 495 gigatonnes.
8. International Energy Agency (IEA) (2021) *Net Zero by 2050 - A Roadmap for the Global Energy Sector*, pg 222
9. Guterres, A (2021) *Secretary-General's statement on the IPCC report*
10. For banks: Philipponnat, T. (2020) *Breaking the climate-finance doom loop*, Finance Watch;
11. In terms of prudential rules, this means that banks and insurers should be required to finance activities related to new fossil fuel reserves entirely out of equity (own funds). Equity acts as a buffer that absorbs losses from banks´ and insurers´ financing activities.
12. Vaccaro, J. and Barmes, D. (2021) *Financial Stability in a Planetary Emergency*, Climate Safe Lending Network, Positive Money, in partnership with EIT - Climate KIC and the UN Environment Finance Initiative.
13. For example: Watts, J. (2021) *Climate scientists shocked by scale of floods in Germany*, The Guardian.
14. Finance Watch (2021) *Amendments proposal to the CRR and SII*

Recipients & corresponding asks

1. **COP President Alok Sharma**
    - **Ask**:

As you shape the vision of the final outcomes from COP26, you will be preparing a comprehensive plan for preventing a climate crisis. We urge you to recognise the role of capital rules to avert a possible ‘Climate Lehman moment’.

We call upon you to convene leaders of the world around this solution, together with the international standard setting bodies BCBS and IAIS, to trigger decisive action and coordination.

2. **G20 President Mario Draghi**
    - **Ask**:

As your member states participate in the upcoming COP26 summit, they will be preparing their plans for preventing a climate crisis. Bring to their attention the role of capital rules to avert a possible ‘Climate Lehman moment’.

We call upon you to convene leaders of the G20 around this solution to implement it in their respective jurisdictions and promote it at the international level. It is only with the game-changing support of leading economies that this pivotal proposal can come into force.

3. **EU, US, and UK leaders**
    i. Ursula von der Leyen, European Commission President
    ii. Charles Michel, European Council President
    iii. Joe Biden, President of the United States of America
    iv. Boris Johnson, Prime Minister of the United Kingdom

cc. Frans Timmermans, European Commission Vice-President;
Valdis Dombrovskis, European Commissioner for Trade;
Mairead McGuinness, European Commissioner for Financial Stability, Financial Services and the Capital Markets Union;
José Manuel Campa, Chairperson of the European Banking Authority;
Petra Hielkema Chairperson of the European Insurance and Occupational Pensions Authority;

Janet Yellen, United States Secretary of the Treasury;

Andrew Bailey, Governor of the Bank of England
Mark Carney, Adviser for the UK presidency of the COP26

- **Ask**:

During the COP26 summit, you will frame the global ambitions to prevent a climate crisis. We urge you to recognise the role of capital rules to avert a possible 'Climate Lehman moment', and act jointly to trigger decisive action.

Please incorporate the aforementioned ideas in your prudential rules for banks and insurers and promote this solution at the international level. It is only with the support of prominent economies that this pivotal proposal can come into force.

4. **Basel Committee on Banking Supervision (BCBS)**

To: Carolyn Rogers, Secretary General; Hernàndez de Cos, Governer
cc: Frank Elderson; Annika Saarikko; Sri Mulyani Indrawati

- **Adapt letter to focus on banks**

[Remove mentions of insurers + replace 2 sentences after footnote #5: Such events are leading to the destruction of assets and business operations that banks are exposed to. Such events also cause unexpected market movements and asset price swings.]

- **Ask**:

As your leadership proves vital, we urge you to recognise the role of capital rules to avert a possible "Climate Lehman moment". This must-have request falls well in-line with the responsibility held by the Basel Committee on Banking Supervision (BCBS) to set international standards for banks.

Enshrine our proposal within the Basel Framework for banks, and coordinate with IAIS, the standard setter for insurers. It is only with the highly impactful support of the BCBS that this pivotal proposal can be implemented in all jurisdictions.

5. **International Association of Insurance Supervisors**

To: Victoria Saporta, Chair of the Executive Committee
cc. Gary Anderson, Chair of the Policy Development Committee
cc. Dieter Hendrickx, Chair of the Macroprudential Committee

- **Adapt letter to focus on insurers**

[Remove mentions of banks]

- **Ask**:

As your leadership proves vital, we urge you to recognise the role of capital rules to avert a possible “Climate Lehman moment”. This must-have request falls well in-line with the responsibility held by the International Association of Insurance Supervisors (IAIS) to set international standards for insurers.

Enshrine our proposal within the Insurance Capital Standard (ICS) for insurers, and coordinate with BCBS, the standard setter for banks. It is only with the highly impactful support of the IAIS that this pivotal proposal can be implemented in all jurisdictions.

6. **Members of European Parliament**

ECON + ENVI committee
Party group leaders

- **Ask**:

European leaders have committed to mobilise and promote the channeling of capital towards sustainable investments. But as long as there is an effective subsidy for fossil fuel financing, it undermines and counteracts this objective of the European Green Deal and Renewed Sustainable Finance Strategy.

There is an opportunity for decisive action: The EU is reviewing its prudential regulation for banks and insurers. Simple tweaks to the Capital Requirements Regulation (CRR) and Solvency II Directive (SII) can avert a possible “Climate Lehman moment”.[14]

We urge you to secure the game-changing initiative of the European Parliament, so that this pivotal proposal can come into force.

7. **EU Finance Ministers**

- **Ask**:

European leaders have committed to mobilise and promote the channeling of capital towards sustainable investments. But as long as there is an effective subsidy for fossil fuel financing, it undermines and counteracts this objective of the European Green Deal and Renewed Sustainable Finance Strategy.

There is an opportunity for decisive action: The EU is reviewing its prudential regulation for banks and insurers. Simple tweaks to the Capital Requirements Regulation (CRR) and Solvency II Directive (SII) can avert a possible “Climate Lehman moment”.[14]

We urge you to incorporate our proposals in the legislative texts. It is only with the game-changing initiative of the member states that this pivotal proposal can come into force.