CERES, STEVEN M. ROTHSTEIN, ET. AL.

Proposal and Comment Information

Title: LFI -Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, OP-1868

Comment ID: FR-2025-0042-01-C14

Submitter Information

Organization Name: Ceres

Organization Type: Organization

Name: Steven M. Rothstein, et. al.

Submitted Date: 08/14/2025

Ceres Accelerator FOR SUSTAINABLE CAPITAL MARKETS

August 14, 2025

Secretary Ann E. Misback
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551
Via Agency Website: https://www.federalreserve.gov/apps/proposals/

Re: Docket No. OP-1868 – Ceres Response to **Proposed Revisions to the Large Financial Institution Rating System and Insurance Supervisory Framework**

Dear Secretary Ann E. Misback,

Ceres appreciates the opportunity to provide comment and express our strong opposition to the Federal Reserve's July 2025 proposal (Docket No. OP-1868) to revise the Large Financial Institution (LFI) rating system and associated Insurance Supervisory Framework.

Ceres is a nonprofit advocacy organization with over 30 years of experience working to accelerate the transition to a cleaner, more just, and resilient economy. Our Investor Network, Company Network, and Policy Network includes many large US institutional investors and large companies with whom we work on a range of sustainability-related and policy-related issues. The Ceres Accelerator for Sustainable Capital Markets aims to transform the practices and policies that govern capital markets by engaging federal and state regulators, financial institutions, investors, and corporate boards to address weather-driven risk as a systemic financial risk. The comments provided herein represent only the opinions of Ceres, and do not necessarily infer endorsement by each member of our Investor, Company, or Policy Networks.

We urge the Federal Reserve to retain the current 'well managed' definition and the presumption of enforcement when deficiencies arise. The current framework requires firms to be rated satisfactory across capital, liquidity, and governance components. Weakening this standard undermines a core prudential safeguard and reduces accountability for risk management lapses.

Our comment will focus exclusively on weather-related financial risks, where we bring the most expertise. Meanwhile, we also recognize that other emerging risks, such as cyber threats, crypto exposures, and geopolitical disruptions, also merit strong prudential safeguards.

Context of Weather-Driven Financial Risk & Insurance Volatility Risk

The U.S. financial system is already absorbing real and escalating impacts from weather-driven financial risks. In 2023 and 2024, the U.S. experienced historic levels of weather-driven disasters - 28 and 27 separate billion-dollar events, respectively, each leaving behind credit losses, liquidity disruptions, and asset volatility. These are not hypothetical future risks; they are present-day realities.

One major transmission channel is the collapsing availability and affordability of property insurance in high-risk regions. In states like Florida and California, multiple insurers have withdrawn from writing new policies, leaving state-backed entities to cover the growing gap. When properties become uninsurable, or when insurance costs exceed mortgage affordability thresholds, loan defaults rise, property values decline, and banks face heightened credit risk.

Credit risk is exposed to both weather-driven losses and insurance volatility. Insurance pricing is now a quantifiable driver of default. According to a recent research paper co-authored by the Federal Reserve Bank of Dallas, a $500 increase in annual premiums on a $400,000 home is associated with the increase in mortgage delinquency rate by 27%. Force-placed policies, insurer withdrawals, and rising premiums are increasing borrowers delinquency risk, with lenders left holding devalued, hard-to-sell collateral.

Liquidity risks are also increasingly visible. In the wake of floods, wildfires, hurricanes, and other weather-driven disasters, banks can experience significant stress on funding as households and businesses withdraw deposits or tap credit lines to cover immediate needs. These effects can arise rapidly, even in institutions with otherwise healthy loan performance. Research by the Bank for International Settlements shows that natural disaster events may trigger precautionary cash demands that erode liquidity buffers, especially when disaster impacts are widespread or repeated. Even institutions with diversified balance sheets can face sudden liquidity risks and pressures when multiple communities experience overlapping shocks.

These concerns have been underscored by the Financial Stability Oversight Council (FSOC), which has emphasized the need for federal regulators to integrate climate-related financial risks into supervisory frameworks and to ensure that large financial institutions are prepared for both physical and transition risks that may affect financial stability. The FSOC 2023 staff report further emphasized that climate-related financial risks, especially those related to insurance market volatility and credit market stress, require improved risk identification, enhanced disclosures, and stronger supervisory expectations to protect the resilience of the U.S. financial system.

Consequences of Weakened Supervisory Standards

Given this growing risk environment, supervisory rigor, not leniency, is essential. The governance and controls component of the LFI rating framework is the principal mechanism by which regulators assess whether a firm's board and senior leadership are equipped to manage novel and emerging risks—especially those that are difficult to quantify, like changing weather patterns which result in increased frequency and intensity of floods, hurricanes, wildfires, extreme heat, and other natural disasters.

Ceres Headquarters: 99 Chauncy Street, Boston, MA 02111
California Office: 369 Pine Street, Suite 620, San Francisco, CA 94104
ceres.org

Governor Michael Barr's dissent highlights the danger of the proposed change. Allowing a firm to maintain "well managed" status with a known governance failure diminishes the power of the supervisory regime to preempt instability. Governance lapses, whether in risk management oversight, cybersecurity, or internal control, have proven to be leading indicators of larger systemic breakdowns.

The 2023 collapse of Silicon Valley Bank (SVB) illustrated how reliance on "safe" assets can turn into systemic vulnerability when internal governance was weak and regulatory supervision was lax. As a result of the 2018 rollback of Dodd-Frank safeguards raising its regulatory asset threshold to $250 billion, SVB, just under the newly updated threshold, was exempt from enhanced prudential standards, including interest rate risk modeling and liquidity requirements. This allowed the bank to accumulate long-duration bonds without adequately assessing or disclosing their vulnerability to rising interest rates. At the same time, SVB suffered a lack of sufficient governance, including an eight-month vacancy in the Chief Risk Officer position during a period of growing financial stress. These failures left the bank ill-prepared to manage liquidity shocks when depositors began to withdraw funds. The result was a rapid loss of confidence and a $42 billion run, underscoring the importance of strong supervisory standards and internal governance to safeguard financial stability—particularly in a risk landscape increasingly shaped by weather-driven financial shocks.

U.S. Federal Reserve Bank Governor Adriana D. Kugler, while supporting a more balanced framework, cautioned that the proposal "risks going too far", allowing firms with multiple deficiencies within a single component to still qualify as "well managed" without adopting more holistic composite ratings. Recent research by the BIS highlights that acute physical risks, such as floods, hurricanes, droughts, and wildfires, can amplify financial shocks and propagate through credit and liquidity channels. It underscores the need for supervisory frameworks to proactively address these risks.

Systemic Risk Warning

The implications of this proposal extend beyond the LFI framework. Regulatory ratings have downstream impacts on firm behavior, interagency coordination, market expectations, and investor confidence. Inadequate governance and risk management at large firms, particularly in the face of accelerating weather and insurance shocks, may not only create risk within those institutions but also amplify systemic vulnerability across the banking sector. If large firms can retain "well managed" status despite being deficient in one of the critical categories (credit, liquidity, governance), other institutions may follow suit, deprioritizing critical investments in weather-driven risk management and operational resilience.

Weather-driven disasters are altering credit risk calculation, liquidity dynamics, repricing assets once considered stable, and pushing legacy models to their breaking point. This is not the time to reduce accountability for managing these risks. It is a moment that demands foresight, prudence, and the maintenance of strong supervisory guardrails.

We acknowledge that some stakeholders argue for regulatory streamlining to reduce perceived compliance burdens or to improve market competitiveness. However, in light of escalating physical risks and insurance disruptions, we believe the costs of insufficient oversight far outweigh the short-term appeal of deregulation. A resilient financial system must incorporate forward-looking safeguards that address weather-driven risks, not relax standards just as those risks are materializing.

Reducing supervisory rigor at this moment risks institutionalizing vulnerability across the banking system, just as weather-related financial shocks become more frequent and severe. Thus, Ceres respectfully urges the Federal Reserve to retain the current definition of "well managed" and uphold the presumption of enforcement action when any core component is rated Deficient.

Thank you for considering our comments on this critical issue. Please contact Holly Li (hli@ceres.org) for any questions or suggestions. Thank you again for your leadership!

Sincerely,

Steven M. Rothstein
Chief Program Officer
Ceres

Holly Li
Program Director, Net Zero Finance
Ceres Accelerator