BETTER MARKETS

CLIMATE

FACT SHEET

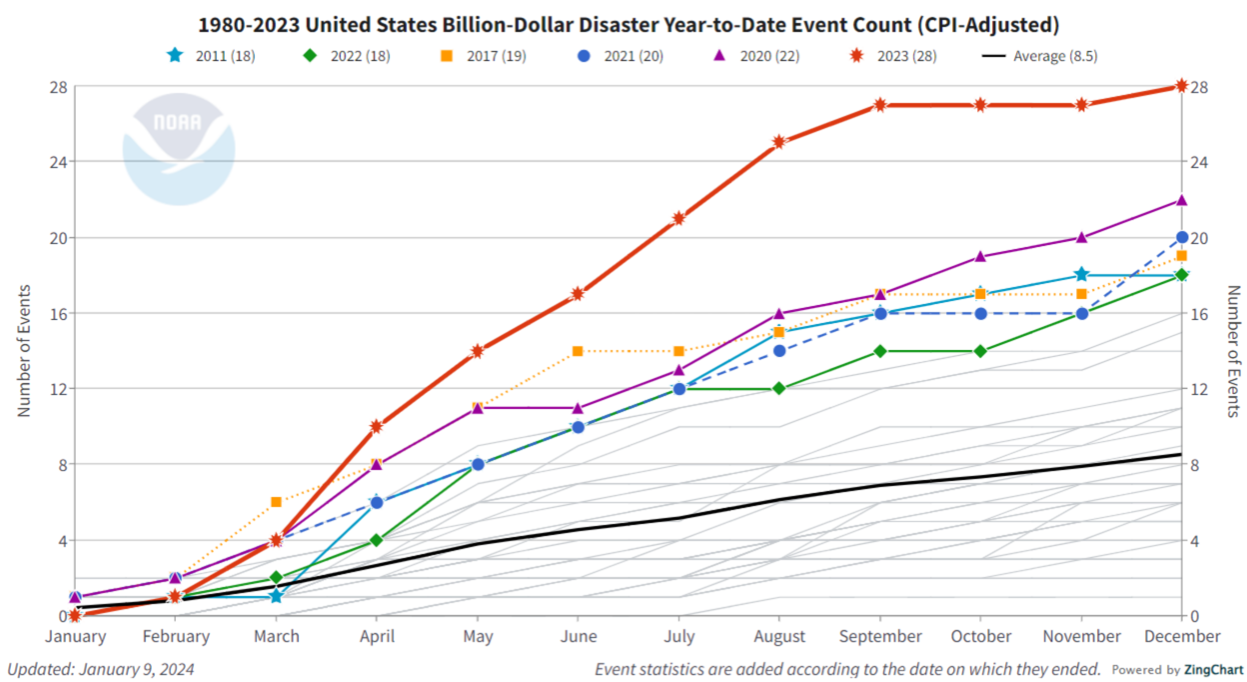
Earth Day Brings Renewed Urgency to Address the Many Financial Risks Caused by Climate Risks

April 22, 2024

Introduction

In 2023, the United States experienced a record 28 weather and climate disasters that cost at least $1 billion each. The total cost of these 28 weather and climate events was at least $92.9 billion. These events also caused at least 492 direct or indirect fatalities.

Unfortunately, the record number of billion-dollar disasters in 2023 is part of a trend. 2023 was the fourth consecutive year in which 18 or more separate billion-dollar disaster events impacted the United States. This marks "a consistent pattern that is becoming the new normal."



Source: 2023: A historic year of U.S. billion-dollar weather and climate disasters | NOAA Climate.gov

Between 1980 and 1989, there were only 33 separate weather and climate events that each cost at least $1 billion. So there were almost as many such events in 2023 alone as there were in the entire 1980s. By the 2010s, the number of weather and climate events that each cost $1 billion almost exactly quadrupled to 131. Yet in the last three years, the total number of weather and climate events that each cost $1 billion is 66—more than half the number in all of the 2010s. These statistics demonstrate that there can be no dispute about the increasing frequency with which the United States faces billion-dollar disasters as a result of climate change.

Select Time Period Comparisons of United States Billion-Dollar Disaster Statistics (CPI-Adjusted)

Time Period	Billion-Dollar Disasters	Events/Year	Cost	Percent of Total Cost	Cost/Year	Deaths	Deaths/Year
1980s (1980-1989)	33	3.3	$213.6B	8.0%	$21.4B	2,994	299
1990s (1990-1999)	57	5.7	$326.8B	12.3%	$32.7B	3,075	308
2000s (2000-2009)	67	6.7	$604.2B	22.7%	$60.4B	3,102	310
2010s (2010-2019)	131	13.1	$967.5B	36.4%	$96.8B	5,227	523
Last 5 Years (2019-2023)	102	20.4	$603.1B	22.7%	$120.6B	1,996	399
Last 3 Years (2021-2023)	66	22.0	$431.5B	16.2%	$143.8B	1,690	563
Last Year (2023)	28	28.0	$92.9B	3.5%	$92.9B	492	492
All Years (1980-2023)	**376**	**8.5**	**$2,661.1B**	**100.0%**	**$60.5B**	**16,350**	**372**

Source: 2023: A historic year of U.S. billion-dollar weather and climate disasters | NOAA Climate.gov

If not addressed, the impact of climate change will not only make our environment uninhabitable but will also hurt the financial well-being of working Americans throughout the country, whether in terms of the growing cost of taxpayer-funded disaster relief, the dramatic rise in underinsured and uninsured homes and businesses, or economic instability.

The simple fact is that climate change makes life more expensive.

> Food, housing, labor—it all gets pricier as the Earth heats up. . . Climate-driven weather disasters, like heat waves, floods, hurricanes, and wildfires, are particularly expensive. They destroy homes and businesses, wreck crops and create supply shortages by delaying trucks, ships, and trains. Such disasters make it more likely that families will go bankrupt . . . .

Addressing the Financial Risks of Climate Risks

As we celebrate Earth Day this year, it is increasingly evident that both the negative effects from climate change and the significant policy changes required to forestall the worst of those effects will touch nearly every aspect of society. This includes the economic impacts, which one study confirmed will be broadly devastating, applying "to poor or rich, and hot and cold countries alike." By one estimate, climate change could cost the American economy 2% of GDP per year. Another study determined that climate change could wipe off $23 trillion in global wealth by 2050.

As these statistics demonstrate, "[f]inancial reforms that address climate risk are urgent." As discussed in a report on climate change and the financial system,

> Because climate change threatens our financial system and, indeed, our entire economy, the United States needs to take action to prevent adverse economic impacts and protect our communities from its wide-ranging impacts. Financial regulators have a key role to play in this effort. . . . Addressing climate risk is therefore a critically urgent task for financial regulators and one for which they have both legal authority and the tools necessary to act.

Given the clear and increasing impact of climate change across various sectors, evidenced by the growing frequency of climate disasters and the escalating financial losses, the urgency for regulatory bodies to adapt and respond to protect individuals, businesses, and financial stability has never been more apparent. Within this context, the financial regulatory agencies must recognize and protect the financial system from climate-related financial risk (Climate Risk). Fortunately, the financial regulators are beginning to take action to address climate change.

This Fact Sheet reviews some of those actions by the financial regulatory agencies and offers some recommendations on further work that is needed to protect the public from Climate Risk.

The SEC

Climate-Related Disclosures

On March 6, 2024, the Securities and Exchange Commission (SEC) adopted a rule requiring that public companies disclose certain climate-related information in their registration statements and annual reports. The rule requires disclosures about a company's climate-related risks and, in some cases, greenhouse gas (GHG) emissions. The rule also requires disclosures about the effect on the company's financial statements of severe weather events and other natural conditions.

The SEC adopted this rule after finding that investors had expressed a need for information regarding how public companies consider or manage climate-related risks. That is because, as the SEC stated, climate-related risks, their impacts, and a public company's response to those risks "can significantly affect the company's financial performance and position." As a result, investors seek information to assess how climate-related risks affect a company's business and financial condition to better make decisions to buy, sell, or hold securities in their portfolio.

Unfortunately, as Better Markets noted, the rule that the SEC adopted did not contain some of the most important elements of the rule that it first proposed. Specifically, as SEC Commissioner Crenshaw detailed, the proposed rule contained "a more robust GHG emissions reporting requirement" and "transition-related expenditure disclosure in the financial statements." That is why the rule must be just an initial first step toward a much more effective, robust, and complete climate-risk disclosure regime.

Notwithstanding the fact that the SEC weakened the final version of the rule, industry filed seven different lawsuits seeking to have the rule vacated. Environmental groups also sued the SEC for failing to adopt a stronger rule. The challenges have all been consolidated before the Eighth Circuit.

Investment Company Names

Prior to its adoption of the climate disclosure rule, the SEC adopted a rule to require that a fund whose name include terms suggesting a focus on an environmental, social, or governance (ESG) factor have a policy to invest at least 80% of the value of its assets in the type of investment suggested by its name. The SEC recognized that funds that consider the ESG factors in their investment strategies may use "terminology that may be especially powerful in fund names to attract investors." But this creates a risk of misleading investors where funds may have a name that suggests a focus on one or more of the ESG factors without investing in the manner suggested by the fund's name. The SEC's rule prevents funds from including terms such as "ESG" and "Sustainable" in their names to attract investors, without changing the investment policy of the fund.

ESG Disclosures for Investment Advisers and Investment Companies

The SEC has also proposed a rule to require investment advisers and investment companies to provide enhanced disclosures about their ESG investment practices. The rule would establish a standardized ESG disclosure framework that would create more reliable, consistent, and comparable disclosures for ESG funds based on the extent to which a fund considers the ESG factors in its investment selection and issuer engagement processes. In light of the materiality of the ESG factors to financial performance, investors need a way to compare the claims that funds make about the role of ESG in their investment strategies.

Otherwise, as the SEC stated in proposing the rule, there is a risk that investment advisers and investment companies marketing ESG strategies "may exaggerate their ESG practices or the extent to which their investment products or services take into account ESG factors." With respect to environmental and sustainability factors, this practice is often referred to as "greenwashing." Greenwashing makes it difficult for investors "to make better informed decisions that are in line with their ESG investment goals and to assess any GHG-related claims a fund has made."

The proposed rule combats the potential for greenwashing by requiring various disclosures. The rule identifies three types of ESG funds—Integration Funds, ESG-Focused Funds, and Impact Funds. Advisers and funds would need to disclose varying ESG information to investors based on the level of consideration given to ESG factors within the fund's strategy—a layered approach.

The SEC should promptly finalize the proposed rule. As Better Markets detailed, the disclosures in the rule "will satisfy growing investor demand for material information that can guide their investment decisions and at the same time protect them from misleading and abusive claims surrounding ESG investment strategies."

The Banking Regulators

The banking regulators – the Federal Reserve Board ("Fed"), Federal Deposit Insurance Corporation ("FDIC), and Office of the Comptroller of the Currency ("OCC") (collectively "Banking Regulators") – especially the Fed have been slow to recognize and tepid at best in addressing the financial risks of Climate Risk. For example, the Fed was the last major central bank to join the Network of Central Banks and Supervisors for Greening the Financial System, which only happened in December 2020.

There appears to be a fear that if the regulators do virtually anything related to Climate Risk that they will be accused of being "climate regulators." However, that fear has resulted in their failure to do their primary job: ensure that the financial system protects itself from risks regardless of source, which includes Climate Risk. Put differently, Banking Regulators must be as ruthless in regulating risks as they are agnostic as to their cause.

Management of Banks' Climate Risks

In October 2023, the Banking Regulators issued principles for Climate Risk management guidance that apply to large financial institutions, with total assets of $100 billion or more. While issuing principles-based guidance and integrating climate risks into the supervisory assessment process is helpful, guidance alone is not enough to ensure that banks adopt suitable practices to address Climate Risk.[1] The Banking Regulators must work together to propose a rule that will be enforceable and give the American people the protections that Climate Risk dangers warrant.

Scenario Analysis

While extremely limited and narrow, the Fed has also embarked on a climate scenario analysis exercise to better understand Climate Risk vulnerabilities at banks. The pilot includes physical and transition risk scenarios. The nation's six largest banks are to assess how these scenarios would affect loan portfolios, including real estate and corporate credit. The exercise has no supervisory consequences but could yield some important insights to inform future policy actions, which should follow quickly. While the exercise reportedly was to conclude at the end of 2023, results have not yet been publicly disclosed.

International Standards

Internationally, banking regulators have also embarked on a broad effort to incorporate Climate Risk into supervisory processes. In July 2021, the Financial Stability Board (FSB) published a comprehensive Roadmap to address Climate Risk, which was endorsed by G20 Finance Ministers and Central Bank Governors and subsequently by G20 Leaders. It addressed the need for coordinated action with the large and growing number of international initiatives underway by outlining key actions to be taken by standard-setting bodies and other international organizations over a multi-year period in four key policy areas: firm-level disclosures, data, vulnerabilities analysis, and regulatory and supervisory practices and tools.

Better Markets has supported the Basel Committee's effort to develop and employ principles for effective management and supervision of Climate Risk at internationally active banks. This includes the integration of Climate Risk into existing risk management efforts. It also includes qualitative and quantitative disclosure requirements for Climate Risk which would increase and improve the consistency, comparability, and reliability of Climate Risk exposure information among internationally active banks. Regrettably, recent reports indicate, however, that the Fed and other US regulators have blocked efforts to advance work to integrate Climate Risk into global financial

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1 This is all the more important because the Fed has a rule specifying that guidance does not have the force and effect of law, and that the Banking Regulators do not take enforcement actions based on guidance. Draining guidance of authority and power requires that the Banking Regulators promulgate a rule related to Climate Risk.

rules, citing a narrow mandate that only allows for a limited interpretation of Climate Risk. That thinking, if true, is simply wrong and inappropriately constricts the Banking Regulators' broad mandate to address risks to the financial system regardless of source.

The Banking Crisis Behind the Climate Risk Insurance Crisis

The tangible repercussions of climate change are becoming increasingly evident across economic sectors and the broader financial system, signaling a transformative impact on global economic structures, financial systems, and, ultimately, individual livelihoods. For example, the exodus of property and casualty (P&C) insurers is endangering the livelihoods of Main Street families, small businesses, and entire communities, sowing the seeds of a financial crisis rooted in climate risk. Indeed, insurance is critical to protect everything from residential homes to commercial buildings from catastrophic losses, often related to climate events. It is important to remember that most of those residential homes, commercial buildings, and other physical structures are collateral supporting loans on the balance sheets of most of the banks in the U.S.

P&C insurers have suffered extreme losses of more than $20 billion in both 2022 and 2023, up sharply from just $5 billion in 2021. The number of insurance companies going bankrupt, withdrawing from states, limiting coverage, and significantly raising premiums is increasing by the day. In addition, the reinsurance market, which is key to resilience in the face of major climate events, is facing reduced investor demand, which will in turn lead to decreased coverage while increasing costs even more.

Simply put, Climate Risk puts banks of all sizes at risk of material financial loss if not failure, and the cumulative effects of the resulting financial risk could endanger financial stability. To date, a key reason that banks have had limited losses and no failures from Climate Risk is because public programs and private insurance companies have absorbed most of those losses. These entities shield banks from first-order losses in many climate-related disasters. However, as insurers fail and exit markets, more risk transfers first to borrowers, but importantly then to the banks holding the now uninsured collateral that has been wiped out due to Climate Risk materializing.

To begin to address this, Better Markets supported efforts to increase collection of standardized data on insurance to increase transparency on insurance availability for all Americans. In March 2024, the U.S. Treasury announced a partnership between the Treasury's Federal Insurance Office ("FIO") and the National Association of Insurance Commissioners ("NAIC") to conduct the data collection. This is the absolute minimum first step, but much more needs to be done quickly before more climate risks materialize and exacerbate the growing insurance crisis, which is inevitably going to lead to a banking crisis. This is not an "if" issue; it is a "when" issue and needs to be seriously addressed now.

The CFTC

Voluntary Carbon Markets

Carbon markets, especially voluntary carbon markets, may play a critical role in achieving the global commitment to combat climate change, exemplified by the Paris Climate Agreement. These markets offer a mechanism for financing carbon reduction and capture projects, but their effectiveness depends on transparency, integrity, and efficiency. Studies have demonstrated that companies that participate in carbon markets invest more and make more progress in curbing their carbon emissions compared to those not involved in carbon markets. The Commodity Futures Trading Commission (CFTC) has a key role to play, and Better Markets has been pushing the agency to leverage its expertise and resources to enhance these markets and ensure that they play their proper role in addressing Climate Risk.

In 2023, the CFTC took significant steps to improve the voluntary carbon markets. First, the CFTC issued a press release calling for whistleblowers to report misconduct in the voluntary carbon markets. Then, the agency's Division of Enforcement announced the establishment of an environmental fraud task force dedicated to combatting fraud in regulated derivatives markets and relevant spot markets. Towards the end of the year, the CFTC proposed guidance highlighting key considerations for designated contract markets in relation to specific elements of the Commodity Exchange Act and related CFTC regulations applicable to the listing of voluntary carbon credit derivative contracts for trading.

CFTC Needs to Act Now

Despite these proactive measures, the timing and future impact of the proposed guidelines remain uncertain. The initiative, while a step towards addressing concerns in the carbon market, raises questions about its timeliness and the potential for significant delays in implementation. With more than three years passed since President Biden's inauguration and with the November presidential elections looming, too much time has passed and there's a real possibility that changes in administration could alter or halt the progress of finalizing the proposed guidance. Furthermore, the process of finalizing these guidelines, which involves reviewing public comments, could extend over several months, adding to the uncertainty.

That's why it's crucial for the finalization process of the proposed guidance to proceed as quickly as possible. Clear standards for voluntary carbon credit derivatives are essential for the integrity of carbon markets and the broader fight against climate change. The proposed guidelines' focus on accurate representation, verification, and reporting of carbon credit transactions is critical and marks a good step forward in ensuring that voluntary carbon markets contribute effectively to environmental goals.

CFTC Must Establish Guidelines and Green Milestones

Moreover, to ensure progress in the voluntary carbon markets is measurable and transparent, the CFTC must establish a series of strategic, time-bound guidelines designed to assess the real impact of these markets on climate change. These "green milestones" could and should serve as critical benchmarks, enabling stakeholders to determine whether the voluntary carbon market is a viable tool in the fight against climate change or merely an illusion of progress. Through rigorous definition, monitoring and evaluation of these milestones, the CFTC can help determine whether the voluntary carbon market is a concept of climate change's "fool's gold," or a genuine mechanism contributing effectively to global environmental goals.

Conclusion

As demonstrated above, the financial regulatory agencies have all begun to address Climate Risk to varying degrees. Nonetheless, much more needs to be done much more quickly given the gravity of the situation and the speed at which climate change is impacting the world. A recent study suggests that climate change will inflict losses to the global economy worth $38 trillion annually by 2049. The same study forecasts an income reduction of 19% globally by the middle of the century. Financial regulators must do everything possible to minimize and mitigate the effects of climate change.

Better Banks | Better Businesses

Better Jobs | Better Economic Growth

Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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