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Financial Regulators' Refusal to Recognize Clear, Well-Known Climate Risks is a Dangerous and Costly Mistake

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November 19, 2024

Recent hurricanes have caused unimaginable losses of human life in the Southeastern U.S. and also resulted in significant costs to Main Street Americans, small businesses, banks, insurers, and taxpayers. Hurricane Helene was the deadliest storm since Hurricane Katrina and Hurricane Milton left a wake of destruction that stretched across the entire state of Florida. These two storms are among a long and growing list of billion-dollar weather and climate disaster events tracked by the National Oceanic and Atmospheric Administration ("NOAA"). From January through October of this year, there were 24 such events nationwide, trailing only the record 28 events in 2023.

Historically, insurance has provided consumers, businesses, and banks with a vital buffer of protection against catastrophic losses from climate events. However, insurers are increasingly withdrawing coverage in the riskiest areas, leaving Main Street Americans and businesses vulnerable. At worst, consumers and businesses will have no protection against devastating climate event-caused losses; or at best, if they can find new coverage, it will almost certainly be at a higher cost or protect against fewer perils. The risk of significant and costly losses for Main Street Americans is very real, as experts estimate that losses from Hurricane Milton alone could be $34 billion with up to ***$6 billion of that total being uninsured losses that will fall directly on individuals, businesses, and lenders***.

Because at least some of those losses had to be collateral on loans, some amount of the $6 billion in uninsured losses will result in losses to banks and other lenders. That's the banking crisis hiding behind the climate crisis that we detailed in a recent report. The $28 billion in insured losses will likely lead to more insurance companies raising rates, limiting coverage, and leaving high-risk markets altogether. That is only going to increase lenders' exposure and risk to unprotected collateral and increase future losses as more affected climate-event victims are unable to repay loans such as mortgages or credit card payments.

To date, actions by the Federal Reserve ("Fed"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC") (collectively, the "Banking Regulators") have been inadequate to the point of dereliction in responding to the climate-related financial risks that threaten our banks. They fall well short of other countries' progress, particularly in Europe, to recognize climate-related financial risks and protect the financial system from them. Recent reports indicate that the Fed has gone against the international Basel Committee and refused to require banks to disclose climate risks, even though these risks threaten banks in the same way as other risks that banks are required to disclose. Simply put, the American people deserve—and the financial system requires—regulators that hold banks accountable for all risks, regardless of the source. Instead, the Fed and other regulators have simply accepted the fact that the country's largest banks are unaware of their risks, unable to measure their exposures to these risks, and lack the systems to monitor and manage these risks – all as proved by the results of the recent climate scenario pilot.

This must change and it must change quickly. Below, we provide five ways that the management of climate-related financial risks must change:

1. **Require enforceable rules that all large banks include climate-related financial risk in supervisory assessments, just like any other risk that affects the bank's safety and soundness.**

   As Better Markets detailed in October 2023, guidance alone is not enough to prompt banks to adopt suitable practices to address climate risks. Furthermore, the Basel Committee for Banking Supervisions' 2022 Principles for the Effective Management and Supervision of Climate-Related Financial Risks states that **all banks** are potentially exposed to climate-related financial risk, regardless of size, complexity, or business model. Therefore, banks and their supervisors must consider these risks to protect consumers and the financial system.

   Climate risk experts detail that banks of all sizes are vulnerable to climate risk. In May 2024, the results of the Fed's pilot climate scenario analysis revealed serious and unacceptable failures of the largest banks to manage and monitor climate-related financial risk. Despite Fed Chair Powell's baseless dismissal of these results, the Banking Regulators and the next administration must insist on a more robust and regular assessment of risk—particularly at the largest banks and require banks to act on the failures and deficiencies identified.

2. **Improve climate models and scenario analysis used by banks to assess risks.**

   Climate risks are unique and different from other risks that banks face; therefore, the models and data that banks use to assess risk exposures must meet certain standards. As Better Markets detailed in recent advocacy on international climate scenario analysis standards:

   - **Climate data** that is used for risk modeling must be based on internationally agreed-upon information from scientific experts;

   - **Model structures** should be specified and coordinated, at least within reasonable standards, rather than left up to banks' individual discretion, to ensure appropriately rigorous and useful results. For example, the selection of a common and realistic baseline scenario, appropriate amounts of interconnectedness between climate risks and other components of the model, and rational amounts of irreversibility of climate effects must be used; and

- **Time horizons** should be sufficiently long to account for the well-recognized and accepted fact that climate risks have a longer maturation period than other banking risks.

Moreover, tail risk is becoming more problematic, more damaging, and more costly. As international actuaries have detailed, climate events that were once considered very unlikely have become commonplace. Across the country, we continue to set records for new extremes ranging from drought to rainfall to temperature, which in turn leads to increased climate risk vulnerability for banks.

3. **Enhance cooperation between climate scientists and bank regulators.**

As Better Markets has detailed, it is unreasonable to expect the Banking Regulators to have the level of expertise that is required to assess climate risk. Therefore, climate scientists should also be relied upon for relevant forward-looking data and analysis on climate risks. This approach will ensure reasonable levels of plausibility and severity for climate projections. It will also allow comparability of the results of scenario analysis from different banks.

In July 2023, the U.S. Treasury appointed a climate counselor to lead climate programs and bring analytical rigor to work related to climate risk. However, it is unclear whether this has yielded the necessary results.

4. **Broaden and coordinate the collection of data to measure climate-risk vulnerability among Main Street Americans and businesses.**

Better Markets has supported efforts to enhance climate-related financial risk data collection efforts. This is a crucial first step to understanding and measuring the growing problem related to insurance for individuals, homeowners, and businesses. More frequent and costly climate disasters are wreaking havoc on the insurance industry and resulting in a proliferation of underinsured and uninsured properties and businesses. While the effects of climate events are tragic for homeowners and problematic for insurance companies, they are a coming crisis for banks and the financial system.

5. **Recognize the indirect impact of climate events, such as economic disruptions in local communities.**

The damage that climate events wreak on local communities is significant. In addition to the loss of human life and destruction of homes, commercial buildings, and infrastructure, entire industries are often devastated. These industries often form the lifeblood of local communities. For example, Hurricane Helene hit western North Carolina just as its crucial tourism season was beginning. From the famous Biltmore Hotel to the Blue Ridge Mountains, leisure and hospitality accounts for 20-30 percent of employment and economic activity in areas affected by the storm. The resulting devastation will have a lasting negative impact on this area. Hurricane Milton also caused significant damage to Florida’s critical agriculture industry, destroying a range of citrus, vegetables, livestock, and aquaculture. While crop insurance and federal programs may provide some relief, local economies, farmers, and residents face long-lasting challenges as they rebuild.

Banks that operate in the affected areas also face acute challenges as a result of the damage and are reported to have already set aside millions of dollars to cover potential losses from borrowers who are unable to repay outstanding loans because of the storm damage.

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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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