Climate change raising risks of financial disaster for homeowners, insurers and bankers

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The rising weather-related risks from climate change, from coastal hurricanes to western wildfires, are increasingly pinching insurance companies, which are raising rates and pulling back from parts of the country in an effort to stay in business.

Just this summer, two major insurance companies left Florida, adding to the long list of companies that have left the state.

In July, Farmers Insurance announced it would no longer write policies in the state; in August, United Property and Casualty went bankrupt, leaving 22,000 of Floridians high and dry and all Florida residents having to foot the bill to bail it out.

Banks could be next, said Dennis Kelleher of public interest nonprofit Better Markets.

“The banking crisis is only right behind the climate and insurance crisis,” Kelleher told The Hill. “Every time an insurance company sounds an alarm, the banks ought to be shaking in their boots, because they’re getting the bill.”

Unprecedented disasters

The unprecedented hurricane cutting across the Florida Panhandle is just the latest in a string of billion-plus dollar disasters to hit the United States this year.

As of early August — before the fires that leveled Lahaina in Hawaii, and before hurricanes Hilary and Idalia — the U.S. had experienced 15 climate disasters with losses exceeding $1 billion, according to federal data.

Those disasters are becoming more frequent. In the 1980s, an average of almost three months separated such large-scale disasters — but for the last five years, they’ve been coming about every three weeks.

The backstop to these losses is the insurance industry, which has seen its costs increase exponentially in recent years. In 2021, the industry as a whole paid out nearly $4 billion more than it took in — and in 2022, following Hurricane Ian, those losses ballooned more than six times to nearly $27 billion, according to a review by a leading insurance trade group.

In the wake of these disasters, some insurance companies have left areas where the risk is highest, leaving an increasing numbers of Americans without insurance, according to The Wall Street Journal.

That’s a risk for banks since nearly two-thirds of U.S. homeowners are paying a mortgage to a lender — generally a bank.

Banks, in turn, use these homes as collateral in a dizzying array of loans and associated financial derivatives — all of which are based, Kelleher argued, on the increasingly obsolete assumption that the properties themselves are backed by insurance.

In the past, this largely made sense. Banks didn’t worry about losing the real estate the loans were written against — they worried about maintaining the tightest possible spread between the equity homeowners were paying in and the potential losses if they defaulted.

This assumption allowed banks to assume a loan-to-deposit ratio of 80 to 90 percent — meaning a bank may only have 10 cents or 20 cents in deposits or real assets for every dollar it’s lending out.

That kind of ratio gives “very little cushion, but at the end of the day, it’s OK because you’ve got the physical assets,” Kelleher said.

But with the rise of climate change driven disasters, “the quality and reliability of the physical assets have dropped dramatically.”

Add the departure of insurance companies, he argued, and banks face the possibility of undergoing total losses for properties destroyed by disaster — losses that, in previous ages, insurance payments would have largely made up.

Kelleher argued that a wave of defaults is coming — one that will hit small community and regional banks first.

“We’re not talking about a decade, we’re talking over the next several years of there being significant bank and financial system consequences for what the insurance companies are experiencing right now,” he said.

A lack of data

It’s unclear how many uninsured properties exist in the United States, which itself is a danger.

“While you would think that state insurance regulators would have created such a database and series of reports through the National Association of Insurance Commissioners, this is unfortunately not the case,” Carly Fabian, a specialist in insurance and climate change at nonprofit Public Citizen, told The Hill.

Regulators are struggling to catch up. The National Association of Insurance Commissioners in August announced it would build a comprehensive dataset to help identify where “insurance availability and affordability” is more challenging in the U.S.

That’s a move it had once opposed, Fabian noted, “which suggests they’re feeling pressure” to get more data on the problem.

Some progressive lawmakers want state insurers to focus on collecting data to figure out where the risks are worse.

“If you purchase a home in Pensacola today, current sea level rise projections through 2050 mean that your home will likely be under water before your mortgage is paid off,” Rep. Sean Casten (D-Ill.) told The Hill.

He added that as insurance firms catch on and stop writing policies in those areas, “a cascading effect” risks spreading through the financial system, as financial institutions offload loans, potentially threatening U.S. financial stability.

“Congress and federal regulators have an obligation to do more to address this,” Casten said.

Kelleher argued that financial regulators need to demand “stress tests” in which key banking regulators — the Federal Reserve, the Office of Comptroller of the Currency, and the Federal Deposit Insurance Corporation — require banks to audit their risk of failure in the face of different levels of serious climate upheaval.

Even where these tests are performed, it isn’t clear that banks are taking them seriously. In a stress test performed by the European Central Bank (ECB) that imagines a world in which global heating reaches 3 degrees Celsius by 2050 — three times its current level — banks assumed their total losses would be just $78 billion.

This number, the ECB itself noted, “significantly understates the actual climate-related risk.”

The role of fossil fuels

In the U.S., there’s an added issue: Both regulators and banks are taking heavy fire from the GOP and the broader fossil fuel industry, which is fighting hard to maintain a free flow of credit to the industry.

When the Federal Reserve last year announced it was opening an initial pilot project that would require six banks to audit their climate risk, Republicans cried foul, arguing this was the beginning of a move to defund fossil fuels.

“The Fed’s new ‘pilot’ program is the first step toward pressuring banks into limiting loans to and investments in traditional energy companies and other disfavored carbon-emitting sectors,” former Sen. Pat Toomey (R-Pa.), the then-ranking member of the Banking Committee, said in a statement in 2022.

“There is no risk from global warming that banks aren’t already fully capable of pricing into their decisions, and the Fed’s intrusion into this process only underscores that the real risk is government.”

Whether or not banks are capable, they are “light years” behind insurance, Kelleher said.

“Bankers are all tied up with, you know, accusations of wokeness, and the power and influence of the oil and gas industry. They should be more like the insurance industry, which is, who cares why a climate disaster is coming?”

“The only thing they should care about is, what the risks are, and what they should do about the risks.”

But while their attitude toward reducing their direct exposure to climate change may be different, in one way, Fabian of Public Citizen noted, banking and insurance see eye to eye: Both are happy to keep investing in the very fossil fuels whose combustion makes the problem worse.

“Even as they pull away from homeowners, insurers like State Farm remain major investors in fossil fuels and others like AIG are both major investors and major underwriters of fossil fuel projects and companies,” she said.

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