AFR Americans for Financial Reform

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Climate Change is an Imminent Financial and Economic Threat

Climate risk is financial risk. Climate costs — to individuals, financial institutions, government agencies, and across the financial system — are mounting. For example:

- **Increasingly costly disasters:** In 2024, the United States had 27 confirmed weather/climate disaster events with losses exceeding $1 billion each. Between 1980-2024, there were an average of 9 climate disaster events with inflation-adjusted losses over $1 billion.
- **Uninsured losses rise:** In 2023, U.S. climate and weather disasters caused an estimated $114 billion in recovery costs with about $80 billion (70 percent) of those losses covered by insurers. In just the first three quarters of 2024, U.S. disasters reached $145 billion with about $80 billion (55 percent) insured losses. With the first major disaster of 2025 — the fires across Los Angeles — early estimates put total economic losses from $95 to $164 billion with insured losses about $75 billion. As of writing, the state insurer of last resort has already been approved for a bailout of $500 million from private insurers and $500 million from homeowners across the state.
- **Homes under threat:** Rapidly rising home insurance premiums are increasing the incidence of mortgage delinquency. Additionally, research predicts that climate change will erode U.S. home values by a total of $1.47 trillion over the next three decades, and that every state and 84 percent of U.S. census tracts would see a decline in overall property value through 2055. Residential properties exposed to flood risk are estimated to be currently overvalued by $121 to $237 billion.
- **Consumer debt is ballooning, and worsens after disasters:** The Urban Institute found that living in a community hit by a medium-sized natural disaster leads to a 5 percentage-point increase in the share of people with debt in collections after one year and to a 10 percentage point increase after four years.
- **Global average temperature rise due to climate change will increase food prices:** Food inflation could increase by as much as three percentage points per year in the next decade, and contribute to increasing overall inflation by about 0.3 to 1.2 percentage points per year.

How does climate change create risks for financial institutions?

Categories of climate-related financial risk include:

- **Physical risk** refers to financial loss as a result of the loss or devaluation of physical assets due to impacts of climate-related physical hazards. Banks, investors, and insurers are exposed to these risks through, for example, mortgages, commercial real estate, municipal bonds, business loans, agricultural loans, and collateral as well as through securities and commodity contracts tied to these markets.
    - Acute risks arise from extreme events, such as droughts, floods, wind, storms, wildfires, and heat waves.

    - Chronic risks arise from progressive shifts in climate, such as rising temperatures, sea level rise, water stress, biodiversity loss, resource scarcity, land use change, migration, and increased building costs to withstand these events.
    - Climate-related impacts are increasing in both frequency and intensity, resulting in:
        - 'Direct' impacts include property damage, reduced productivity, and loss of life.
        - 'Indirect' impacts include decreased property value and supply chain disruption.

- **Transition risk** refers to financial loss as a result of the societal transition away from fossil fuels and other polluting industries towards a low-carbon economy due to changes in government policy, technological innovation, consumer demand, and market shifts. These changes are often necessary to curb climate change.
    - Policy and legal risk can stem from direct or indirect carbon pricing and reporting obligations, regulations of existing products and services, exposure to litigation, and other risks.
    - Market risk can stem from shifts in consumer and investor behavior, government support for technologies, and increasing costs of raw materials.
    - Technology risk can stem from emerging competition with existing products and services from lower emissions options and unsuccessful investment in new technologies.
    - Reputation risk can stem from changes in consumer and investor preferences and increased stakeholder concerns or negative feedback and can result in a higher cost of capital.

What are some examples of transition risk?

For example, fossil fuel (coal, oil, and gas) expansion might result in short term profits, but those investments risk becoming stranded assets in mid- to long-term time horizons. The International Energy Agency predicts that oil demand will peak in the next ten years, and when demand drops, the carbon asset bubble will finally pop and a new financial crisis will likely ensue.

Research estimates that to reach Paris-aligned emissions targets, 34 percent to 49 percent of oil reserves and 77 percent to 97 percent of coal reserves will become "stranded assets." Even under less aggressive emissions scenarios, such as our global trajectory with "no policy" changes beyond current Paris commitments, stranded coal assets are estimated at $1.3 trillion through 2050. Fossil fuel expansion today is creating assets that will likely not produce revenue for their intended economic lifetimes.

What's at stake due to the incoming Trump administration, and what can policymakers and advocates do to address climate-related financial risks?

The Trump administration has moved quickly to destroy federal climate programs and data and exert political influence over financial regulators rather than recognize their statutory independence. Members of Congress and advocates that care about addressing climate change and limiting the economic and financial damage should 1) push back on agency efforts to repeal climate-related financial risk policies, 2) scrutinize the legality of the Trump administration's moves and push back on regulator politicization, and 3) press financial institutions to implement robust climate risk management practices and net zero transition plans.