Rodney's Take

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The Fed and Major Banks Will Study Climate Risk Until They Get the Result They Want

The Federal Reserve has created a pilot program that allows banks to assess their exposure to climate risk and has recruited six major banks to participate in the program next year. The group includes giants Goldman Sachs, JPMorgan Chase, and Morgan Stanley. The Fed claims the program is designed to allow banks to "allow" supervisors and firms to assess and manage climate-related risk and that the program includes no provisions for greater capital requirements or supervisory changes if an area is found lacking.

Who believes that?

Even though the Fed intends to publish program-wide data but not firm-level data, someone somewhere will leak the data and then sue the banks to demand that they cut off clients involved in businesses they don't like. This is the beginning of a witch hunt by the Fed and the banking industry in everything but name, and we know this to be true for one compelling reason. The Federal Reserve Bank of New York (FRBNY) has already studied the effects on banks of natural disasters, including those that may contribute to climate change, such as floods, wildfires, and hurricanes, and found that the events either had an insignificant effect on banking activities or *boosted* revenue and profits due to increased loan demand. The November 2021 report, "How Bad Are Weather Disasters for Banks?" is on the FRBNY

website for all to see, but no one's looking because it doesn't tell the story they want to hear.

Researchers at the FRBNY investigated what happened to local banks as well as multi-county banks in affected areas as a result of natural disasters from 1995 through 2018. They wanted to see if the disasters, both those deemed big enough for a FEMA response and those not, harmed operations or even led to bank insolvency. The unequivocal answer was no. While local banks suffer more negative effects from extreme disasters than multi-county banks, the effects weren't large enough to cause capital concerns and, like multi-county banks, local institutions experienced rising loan volumes after disasters, which increased profits.

The researchers looked into whether this represented a monetary transfer from the national government to such banks in the form of FEMA aid by comparing how banks fared in FEMA-designated disaster areas with how banks fared in disaster areas without such a designation. The results were similar, which showed that FEMA isn't a determining factor.

The paper also highlighted several previous studies that covered how banks fared after disasters in the U.S., other developed countries like Germany, and in the Caribbean. All of these studies reached the same conclusion. While short-term negative effects might have occurred in the immediate aftermath, these effects weren't big enough to cause capital reserve issues and profitability generally increased as the populations rebuilt.

This FRBNY study was completed and published less than a year ago. It's hard to see what could have changed since then that makes it a good use of Fed time and resources to develop a pilot program to restudy the issue or for major banks to commit assets to participate. It's almost as if they don't want good news and will keep spinning the wheel until it gives them what they want, a reason to take the actions their directors want instead of the actions the facts favor.

If the central bankers and private bankers really want a lesson in reality instead of some fuzzy estimates of what they think might happen, they can spend the next six months logging the experience of Floridians in the aftermath of Hurricane Ian. Just like the banks in Houston after Hurricane Harvey, it's likely these lenders will make a lot of money due to the cleanup and rebuilding in the months ahead. Somehow, it doesn't seem likely that any of that data will make it into the Fed's new pilot program report.

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