GIB ASSET MANAGEMENT

Climate and asset risk in the financial sector

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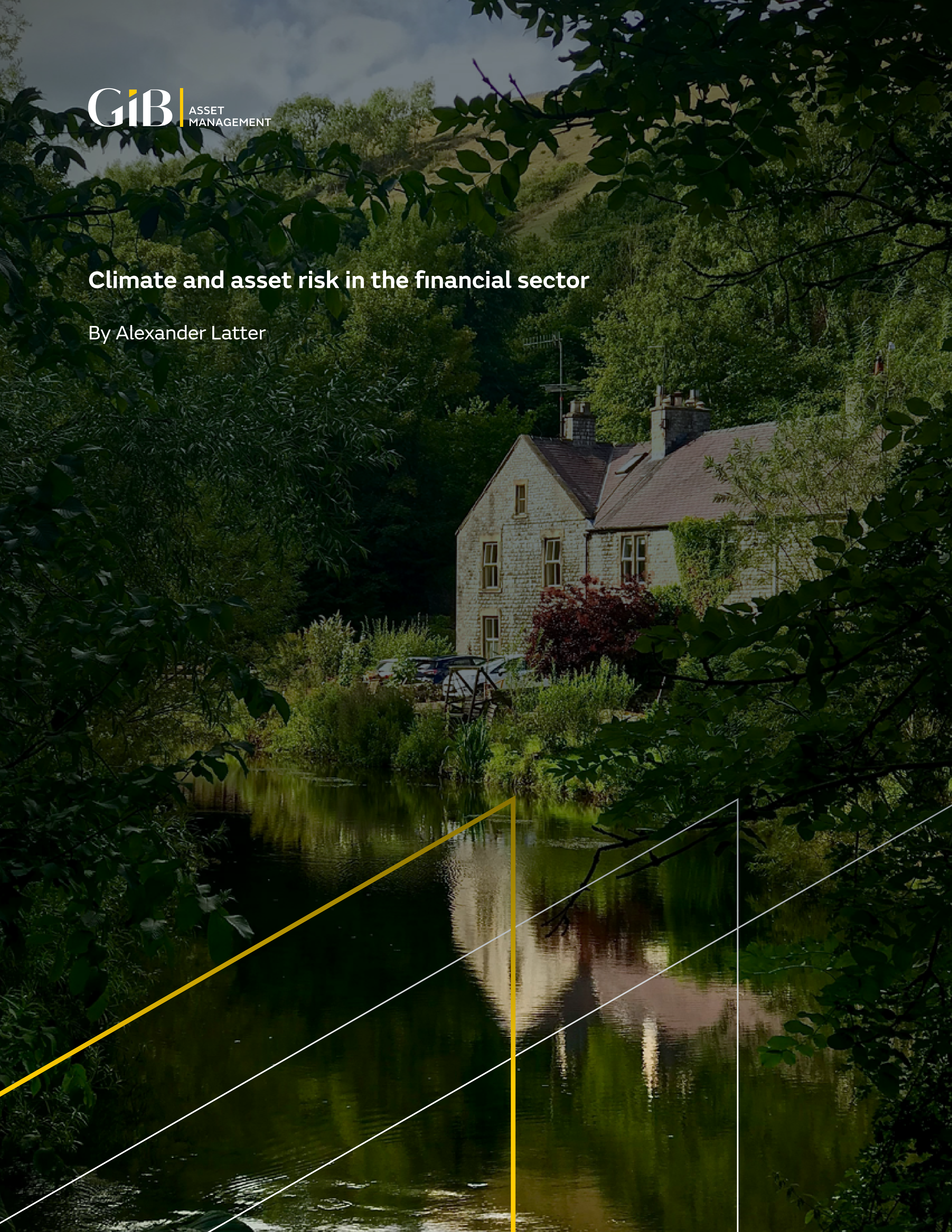


There appears to be a creeping sense of fatigue in the business community around the threat of climate risk. These issues can often feel abstract and distant. The 30+ year timelines can be hard to comprehend when traditional investment horizons and government terms are typically less than five years. However, unbeknownst to many, physical climate risk has been damaging asset values since the early 2000s. With more extreme weather expected, losses are likely to increase. Crucially, we reflect on why historic data is not fit for purpose. This piece highlights the real financial and regulatory risks for firms and argues who is best positioned to capitalise and which firms have the most exposure.

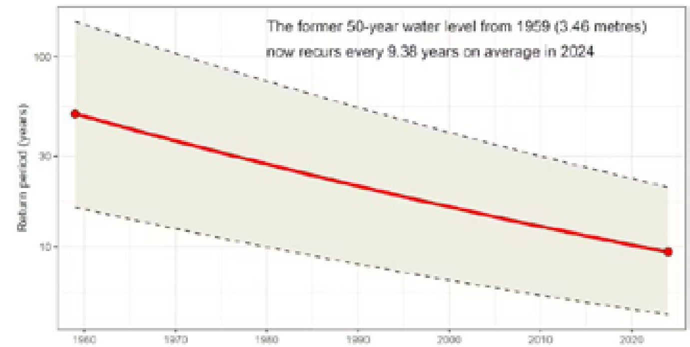
Figure 1: Tewkesbury Abbey[1]

An anecdote

In 1990 my parents bought a house near the quiet English market town of Tewkesbury. Sat on the confluence of the Rivers Severn and Avon, it offered good schools, open fields, quaint villages and decent motorway connections. It seemed a perfect place to raise a young family. There was one flaw. The house that they had purchased was in an area prone to flooding. At a family dinner shortly before the purchase my grandfather, who spent much of his retirement reading tiny articles buried in newspapers, raised the relatively new concept of climate change. 'Don't buy a house on the floodplain, it is going to get worse over the next 20 years' he declared.

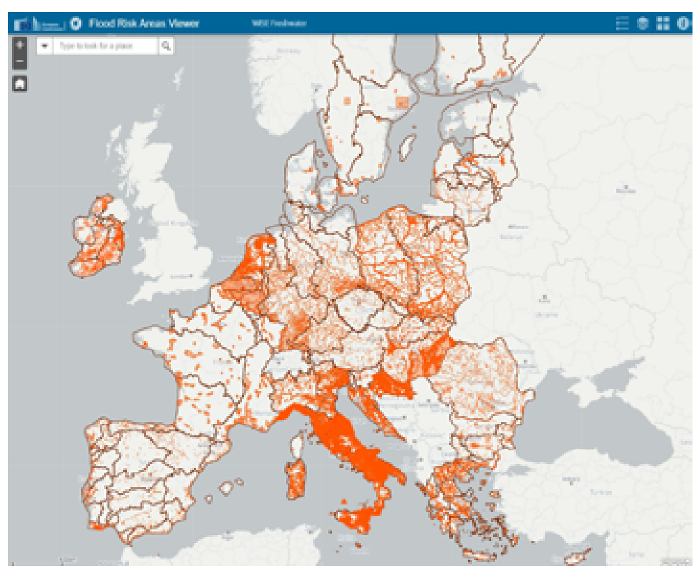
However, my parents went ahead based on the assumption it would take a 1 in 100 year event for water to reach our front door. At the time, this seemed like an acceptable risk. In the 35 years since then, the house has flooded five times! Why? The historic data was not fit for purpose. The subsequent owner of the property has also been impacted, selling the house in 2025 at a value close to the level it was bought from my parents in 2004, despite UK house prices up 1.4x over the same period.

Figure 2: Water level probabilities on the River Trent, England[2]



While the example above is anecdotal, data shows this is far from an isolated incident. A recent analysis on historic river levels globally[3] concluded that in temperate climate zones flooding has increased significantly. This has understandably had an impact on property valuations. Estimates in the UK[4] suggest that properties at risk sell for an 8% discount, and those at very high risk sell for a 32% discount. European studies show similar results albeit with smaller discounts – 6% in the Netherlands[5] and 4% in Italy[6].

Figure 3: EU flood risk map[7]



[1] The wettest summer on record - 10 years on from the 2007 floods
[2] Extreme UK flood levels are happening much more often than they used to, analysis shows
[3] Global changes in 20-year, 50-year, and 100-year river floods
[4] Does flood risk affect property prices?
[5] Capitalised vale of evolving flood risks discount and nature-based solution premiums on property
[6] Floods do not sink prices, historical memory does: How flood risk impacts the italian housing market
[7] Floods Directive | WISE Freshwater

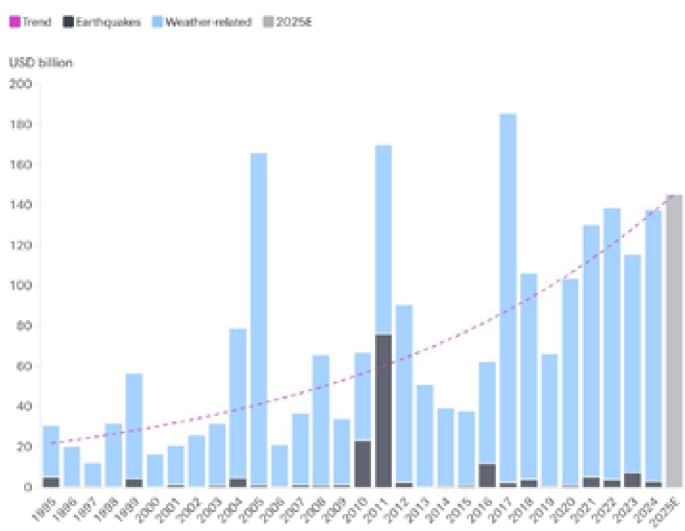
While climate risk can seem abstract, it is certainly not when it puts a 30% discount on your property. The increase in flood levels means that there is a big reset underway in first how insurers, and then banks, assess and price risks, with resulting reductions in property values.

The financial regulator in the UK has identified these gaps in climate risk analysis[8]. Correspondingly, the European Central Bank has identified similar issues[9] at banks under its supervision, with only 20% of lenders considering climate risk as a variable when granting loans. The widespread property destruction in Florida and California as a result of hurricanes and wildfires act as a clear example of the significant financial losses that can occur. Physical climate risk is not a future concern but a clear and present danger.

Implications for investors

It is important to note that climate losses have not yet grown to a level that impacts large, diversified institutions. Banks have a relatively limited exposure at group level, for example NatWest estimates around 3% of its mortgage book is at risk of flooding. Insurance companies have taken some more notable hits but have broadly been able to price for the risk. Where economic pricing has not been possible (see previous examples of California and Florida) insurers have withdrawn from the market entirely. This protects their balance sheets but raises questions around leaving vulnerable populations unprotected. Nevertheless, losses are likely to increase, and we believe it is important for investors to establish which firms are exposed.

Figure 4: Global insured natural catastrophe losses[10]



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Despite climate change slipping off the front pages in 2025, firms relying on traditional 3-5 year models, akin to yesterday's weather forecast, might find the impact of climate risk "lapping at their ankles" before long.

[8] BoE watchdog tells banks and insurers to fix climate risk 'gaps'
[9] Banks must sharpen their focus on climate risk, ECB supervisory stress test shows
[10] Natural catastrophes: insured losses on trend to USD 145 billion in 2025

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