

How Does Climate Risk Affect Financial Safety Net Institutions?

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Abstract

Climate risk causes significant challenges to financial safety net institutions, including central banks, financial regulators, deposit insurance schemes, and resolution authorities. Physical risks arising from extreme weather events, rising sea levels, and changing climate patterns can directly affect the financial health of households, enterprises, and financial institutions by increasing asset losses, disrupting economic activity, and reducing collateral values. Transition risks linked with policy changes, technological advancements, and shifts in market preferences toward a low-carbon economy may further expose financial institutions to a whole catalogue of risks, including credit, market, liquidity, and operational ones. Financial safety net institutions must adapt their frameworks, risk assessment methodologies, and crisis management strategies to incorporate climate-related problems. Enhanced climate stress testing, improved disclosure requirements, and greater coordination are becoming essential tools for identifying and mitigating systemic risks. The aim of the study is to show how, through inclusion of climate considerations into prudential oversight and financial stability policies, financial safety net institutions can strengthen resilience, protect depositors, and support the long-term stability of the financial system.

Keywords: climate risk, financial stability, financial safety net

Doi: <https://doi.org/10.66414/mlabs.9727>

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