Climate Risk – Implications for NDBs

Innovation Lab 4

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Why is Climate Risk important?

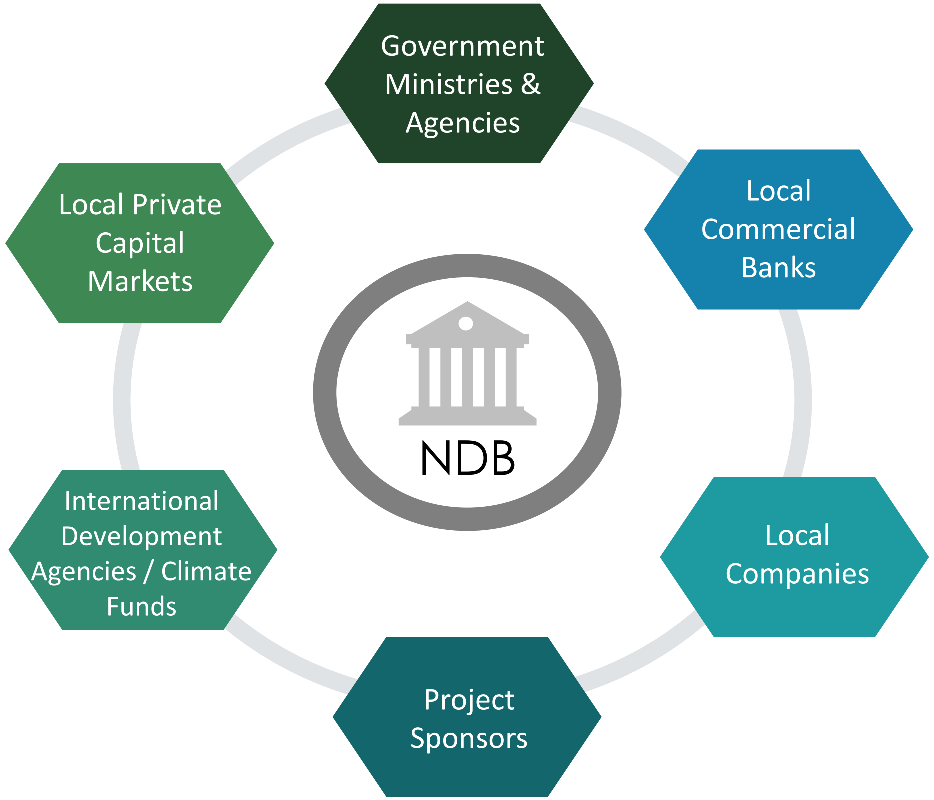
Climate change poses a threat to our systems, economy, infrastructure and habitat.

Climate change is one of the main risks of the twenty-first century with the potential to adversely impact the global economy.

Trillions of dollars in economic losses are expected from physical damage to assets, disruptions to global supply chains and the changes in asset valuations in a business-as-usual trajectory.

The transition to a green economy requires collective action to finance a low carbon, climate-resilient infrastructure system, to invest in climate-mitigating technologies, and to develop alternative energy sources.

Why should NDB's act on Climate Risk?



1. NDBs are uniquely positioned to act on climate risk as they sit at the nexus of key players within the national economy and financial sector.

2. The significant financing required to address the economic implications of climate change urges NDBs to support governments with the mobilization of international resources.

3. NDBs' balance sheets and operations will be impacted by the structural adjustments resulting from the physical and transition risks of climate change.

Climate Change and the Financial System

What are Climate Risks?

Physical Risks

Vs.

Transition Risks

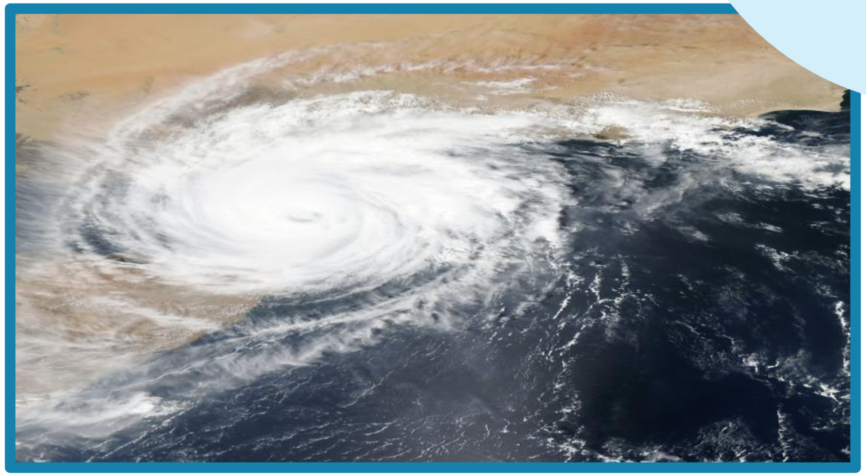
What are climate-related Physical Risks?

- Climate or weather-related hazards
- Results in direct financial losses
- Direct: damage to assets
- Indirect: disruption of supply chain
- Tends to disproportionately affect:
  - The value of long-lived fixed assets;
  - Geographies/climate vulnerable regions;
  - Sectors heavily dependent on water; and
  - Industries with high value chain exposure
- Threatens individual FIs and stability of the entire financial system

Examples of climate-related Physical Risks

- Chronic Risks (long-term changes in climate patterns):
    - Rising temperatures
    - Rising sea levels

- Acute Risks (extreme weather events):
    - Tsunami
    - Flooding
    - Hurricane



What are climate-related Transition Risks?

- Uncertain financial impact stemming from structural changes of shifting to a low carbon economy:
  - Policy
  - Technology
  - Liability / litigation
  - Market
- Financial losses and devaluation of certain assets associated with industries rely on carbon emissions or require fossil fuel in its production
- Impacts future cashflow of businesses

Examples of climate-related Transition Risks

- Carbon pricing: carbon tax or trading, subsidies
- Clean technology
- Litigation charges due to insufficient standards
- Consumer preferences

Climate Risks transmit to Financial Risks

Climate Risks

Physical Risks
- Flooding
- Drought
- Sea Level Rise
- Increased Rainfall
- Extreme Weather Events

Transition Risks
- Policy Change
- Technology Disruptions
- Reputation

Transmission Channels

Companies' value chain
- Supply Chain Disruptions
- Operational Disruptions
- Physical Damage to Assets
- Market Disruptions

Impact on Companies' Financial Statements

Income Statements
- Revenues
- Expenditures

Cash flow

Balance Sheet
- Assets
- Liabilities
- Capital

Macroeconomic Environment

Financial Risks to FIs

Indirect
Credit Risk

Market Risk

Direct
Operational Risk

Reputational Risk

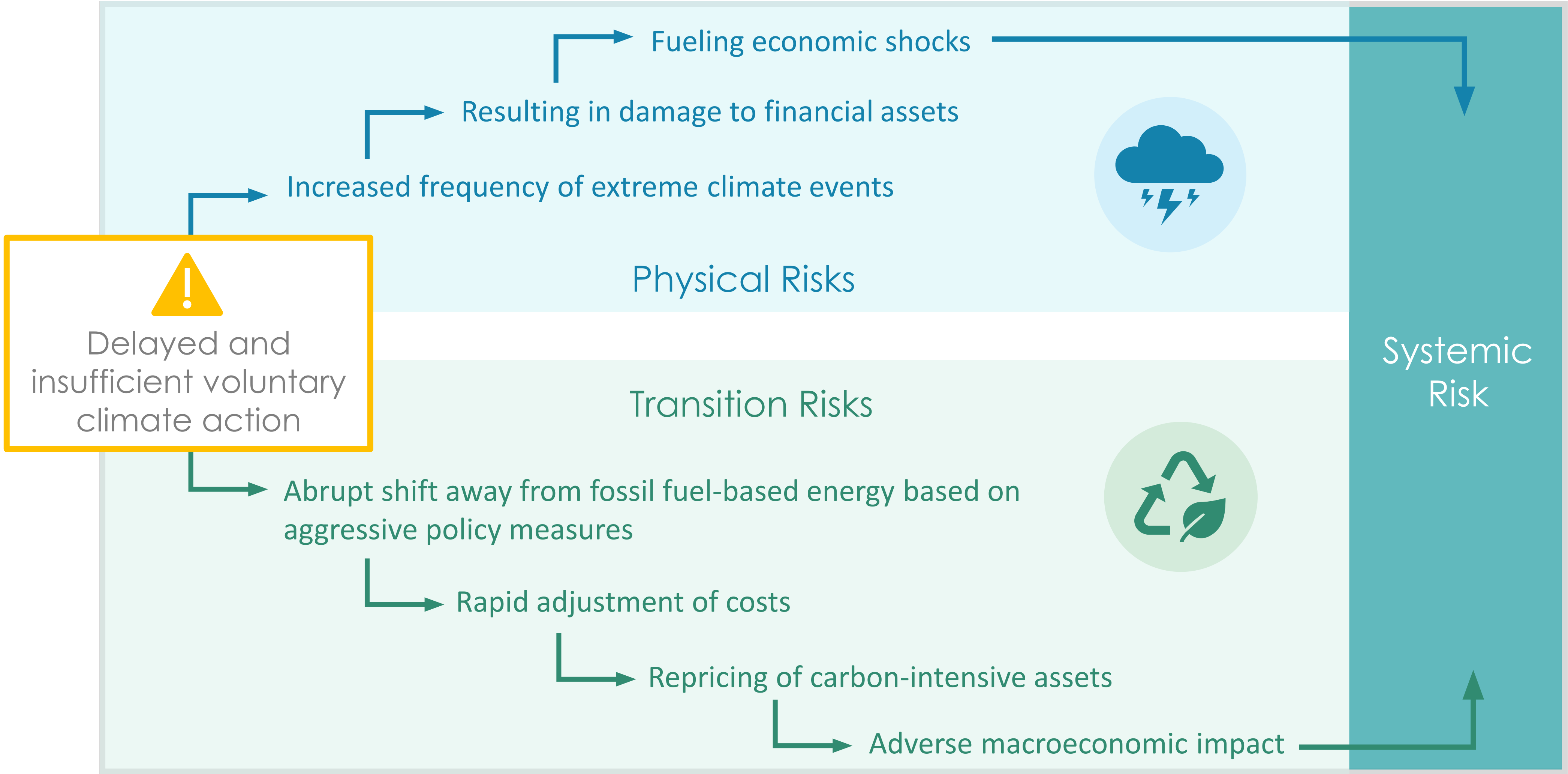
Strategic Risk

Legal Risk

Climate Risk exposes financial institutions directly or indirectly

Indirect	Direct
Credit Risk	Operational Risk
Market Risk	Reputational Risk
	Strategic Risk
	Legal Risk

Climate Change is a Systemic Risk



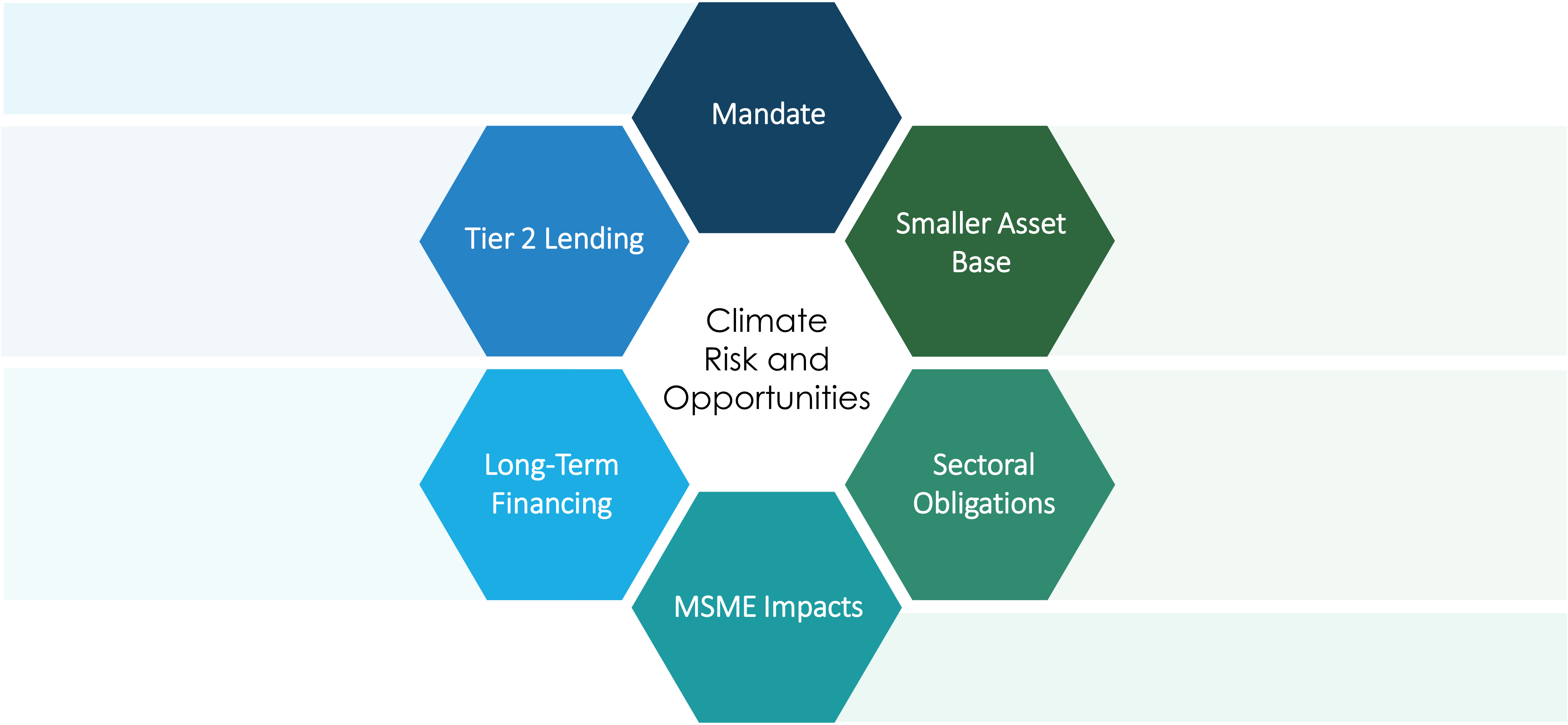
The urgency of climate action has gained momentum among central banks and regulatory authorities

TCFD
TASK FORCE ON
CLIMATE-RELATED
FINANCIAL
DISCLOSURES

NGFS
Central Banks and Supervisors
Network for Greening the Financial System

Climate Risk and National Development Banks

Climate Risks and Opportunities arise from NDB's mandate and structural characteristics



NDBs can play an important role in the transition to a low carbon, climate resilient economy

Financing Opportunities

Enhancing access to sources of finance

Seizing the leadership opportunity

A Climate Risk Roadmap for NDBs

Starting blocks for the reorientation into a more climate-resilient financial institution

“Now is the time to ensure that every financial decision takes climate change into account.”

Mark Carney
UN Special Envoy on Climate Action and Finance, (former) Governor of the Bank of England (December 2019)

Governance

Key activities

- Seek Board commitment on climate risk
- Create a cross-functional Working Group for climate risk management
- Determine the governance processes and structures of key climate-related committees
- Determine the reporting process to inform your Board about climate issues
- Define capacity and resources needs and identify competing priorities
- Build your Bank’s internal capacity and understanding of climate risks at all levels
- Create a Climate Policy and consider adjusting or enhancing policies and procedures
- Define accountabilities and responsibilities for climate risk assessments and reporting
- Set climate risk performance targets to align with remuneration/incentive schemes

Strategy

Key activities

- Develop a Climate Risk Strategy
- Prioritize the Bank's top climate sensitive sectors/clients
- Develop a Strategic Action Plan
- Define strategic planning time horizons
- Determine goals for communicating climate risk strategy

Risk Management

Key activities

- Incorporate climate risk into existing overall risk management framework
- Incorporate climate risks into existing Sustainability Strategy and E&S Policy
- Integrate climate risk elements into ESMS
- Prioritize clients, geographies and sectors for analysis of their climate risk sensitivity
- Disaggregate climate risks and opportunities by sector or geography
- Consider the carbon intensity of your credit portfolio.
- Define relevant Climate Risk Scenarios based on range of factors.
- Encourage local FIs, partners and clients to adopt the TCFD

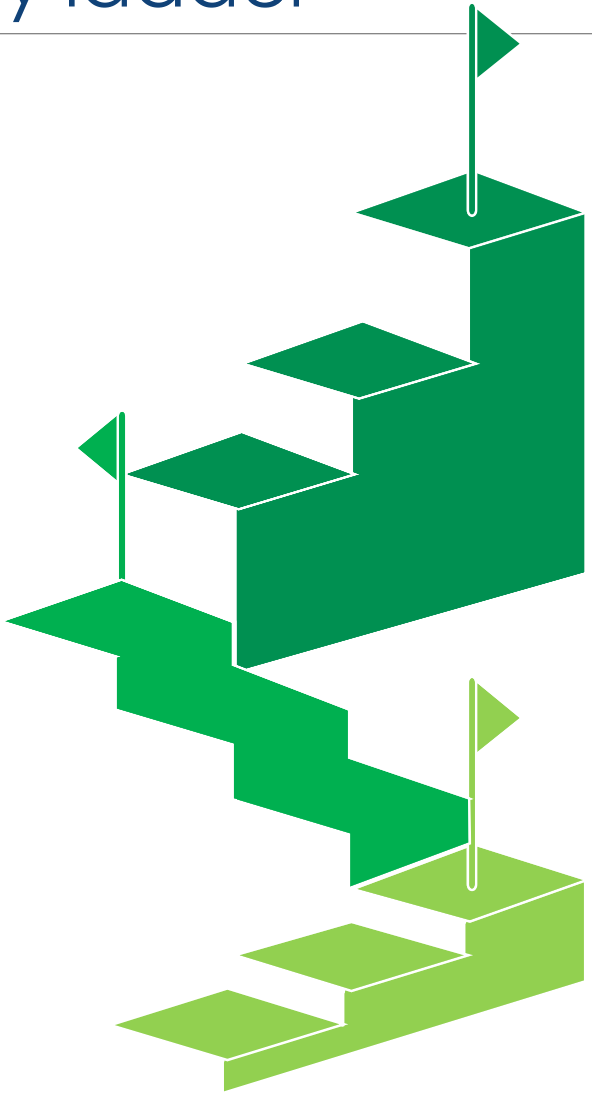
Metrics, Targets, Reporting and Disclosure

Key activities

- Pursue education about the TCFD and move toward adoption
- Engage in education on climate risk disclosure with local FIs and clients
- Set objectives related to climate risk and determine performance indicators

Discussion

Climate risk maturity ladder



Balanced

- Define climate risk appetite by executive management
- Engaged in certain climate finance transactions
- Short-term climate risk analysis
- Data collection on certain climate-related metrics
- Identify climate risk opportunities

Mature

- Mainstreaming climate risk considerations
- Fully climate proofing operations
- Green products and processes
- Short and long-term climate risk approach and analysis
- Clearly defined climate risk appetite,governance, strategy, metrics and targets, integrated into M&E and reporting
- Ex ante and ex post evaluations
- Full internal capacity – HR, IT, Governance, etc.
- Green Bank Model

Nascent

- Business as usual
- Ad hoc or reactionary to climate risk scenarios/opportunites
- Undocumented climate-related impact of investments

Question #1

Where on the maturity ladder do you see your organization and why?

Question #2

Which of the sectors and markets your institution is exposed to are most sensitive to climate risks?

Is your institution more subject to transition risks or physical risks?

Question #3

What would be the next steps for your institution in addressing climate risks?

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Thank you!