COP27 - WHAT MUST FINANCIAL FIRMS TAKE AWAY?

COP27, WHICH CONCLUDED IN EGYPT RECENTLY, WAS HELD AT A TIME OF RAMPANT INTERNATIONAL ENERGY PRICE INFLATION, A LAND WAR IN EUROPE, AND AGAINST A HISTORY OF INCREASING INTRANSIGENCE IN SPECIFIC AREAS OF FUNDING. EVEN SO, SOME ACHIEVEMENTS OF THE CONFERENCE ARE WELL WORTH NOTING BY BANKS.

Climate Risk Perspectives

JADED HORIZON

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History dealt COP27 a difficult hand to play...

Developing countries have called for two specific things for a long time.

The first is 'Loss and Damage' payments from developed nations. Essentially, some countries find themselves at the forefront of physical climate change impacts, which are primarily caused by developed countries. The situation is exacerbated by the fact that even now, richer countries emit many multiples of the greenhouse gasses coming from the worst-affected nations in the world. Historically, wealthier countries have fought against this, as it could conceivably lead to legal claims in the future.

The second, linked, issue is that smaller coastal and island nations desperately need the wider global community to reinforce a commitment to holding global warming this century to 1.5 degrees above pre-industrial levels. If higher targets are allowed to become a replacement for 1.5 as the target, then the damages they would sustain could threaten any viability they have as independent countries, if not wipe them out entirely.

With the COP coming as the Russian invasion of Ukraine has seen energy prices skyrocket, which itself has led inflation upwards, western spending conversations have been more towards military and energy security than climate change.

Since Glasgow, the scientific warnings have only become louder...

At the 26th edition of the COP in 2021, scientific evaluations of the combined Nationally Determined Contributions (NDCs), put forward by countries as a requirement from the Paris accord, reached in 2015, alarmingly predicted that even full rollouts of the plans would see a century end increase of 2.7 degrees. This would be a disaster for the smaller developing nations. Delegates agreed to revisit and strengthen their NDCs in time for the 2022 COP.

As the conference started, very few had done so, and revised analysis showed that the reduction in emissions by 2030 would be around 1% only, a long way from the 43% total reduction needed for 1.5 degrees to be even remotely possible.

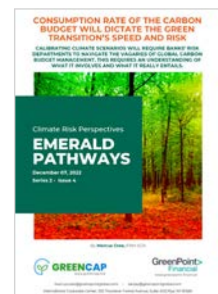
There were some green shoots of hope...

Surprisingly, there was more progress on the 'Loss and Damage' issue than had been seen at any prior COP. The group agreed that a fund ought to be set up, and a transitional committee was created to determine how such a fund would be filled and subsequently run. The key part of this section of the agreement is that outside of some 'pledges', the funding was not determined, and will likely be a mix of public and private initiatives. These, along with the organizational recommendations, are due to be presented to COP28 in the UAE next year.

There was also increased pressure on banks and development banks to ease the flow of money for transitional projects, with a new vision being asked for, in order that such institutions are 'fit for purpose' over the next decade.

As well as continued black holes...

Curtailing carbon emissions depends to a large degree on reaching peak use for fossil fuels sooner rather than later. One proposal mooted was for the summit to agree to a commitment to phase out all fossil fuels, which would have significantly strengthened the Glasgow position. This was not adopted, and it was noted by the Glasgow COP President, Alok Sharma, that to reach the ambitious goal of 1.5, carbon emissions need to peak by 2025, and that this not being committed to represented a significant failure of the conference.

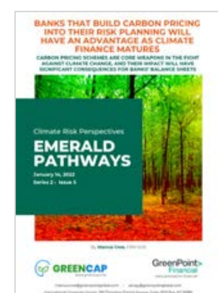


All in all, a disappointing but mixed bag of results...

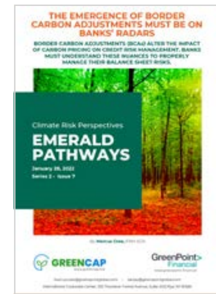
The easy conclusion is that this COP failed to achieve progress substantively, and that this was a sadly predictable outcome, given the geopolitical situation framing it. This misses some important nuances though that banks, in particular, would do well to take note of.

The fact is that a fund has been agreed to, whereby emitters will effectively pay in, while those suffering climate hardship will take out. Even without details, this should put banks on alert that money will need to be raised from the private sector, with the higher emitting industries most likely to be targeted for whatever proposals ultimately come forward. Conceivably, funds could be raised from:

- Wider adoption of Carbon 'cap and trade' schemes, which have the advantage of locking in a base level of energy security as well as charging for emissions or the introduction of carbon tax schemes.



- Creation of carbon border adjustments to prevent such schemes from simply incentivizing offshoring of CO_2 emissions.



Any or all of the above would act as a profit drag to 'brown' industries and firms, as well as an additional bonus for those companies already investing in 'greening' their operations. The implications for future costs and credit profiles are significant, as it threatens to turn the economic order on its head, with fossil fuel utilities becoming a greater risk to bank balance sheets than sustainable start-ups.

Another potential impact of a 'Loss and Damage' fund is that governments may escape historic 'reparation' payments, but subsidizing future emission growth could carry high financial penalties once the president for the fund is in place.

These should be considered by banks, as they choose lending strategies going forward, or else they may find that their credit risk costs outweigh any short-term gains to be had from a 'business as usual' approach. Climate scenario analysis, centering on transitional costs and how they may be borne, needs to become a staple reporting requirement in every bank's risk department.

GreenCap can help...

GreenCap is a turnkey, 'Risk as a Service' (RaaS) solution that gives banks the capacity to run multiple climate scenarios and pathways and view the impact they have on:

- Loan pricing
- Balance sheet profitability
- Expected and unexpected losses (credit risk capital)
- Borrowers' probability of default

GreenCap is built on the philosophy that banks need a solution that allows them to view climate change in banking terms. Without such a solution, they are caught between current banking rules around credit risk and the urgent need to finance the transition to a sustainable economic future.

Visit greencap.live for more insights and resources written and curated to enable financial institutions to make informed choices and keep themselves on the right side of history.

ABOUT
GREENCAP

- GREENCAP is a turnkey 'Risk as a Service' (RaaS) solution, designed for banks to include climate change as a category in their risk management frameworks.
- The solution allows banks to replicate climate pathways within their scenarios for economic impact and risk analysis.
- Using GreenCap, banks can modify pathways and scenarios to include the timing effects of delayed sustainability transition measures.
- Loans and credit facilities are measured and monitored against risks arising from both 'physical' and 'transition' impacts.
- GreenCap provides support for risk reporting and governance in the areas of 'Responsible Banking' and climate change.
- With GreenCap, banks can ensure that their climate strategies are financially grounded, and loan pricing is optimized throughout the transition to a green global economy.

ABOUT
GREENPOINT FINANCIAL

- GreenPoint Financial is a division of GreenPoint Global, which provides software-enabled services, content, process and technology services, to financial institutions and related industry segments.
- GreenPoint is partnering with Finastra across multiple technology and services platforms.
- Founded in 2006, GreenPoint has grown to over 500 employees with a global footprint. Our production and management teams are in the US, India, and Israel with access to subject matter experts.
- GreenPoint has a stable client base that ranges from small and medium-sized organizations to Fortune 1000 companies worldwide. We serve our clients through our deep resource pool of subject matter experts and process specialists across several domains.
- As an ISO certified by TÜV Nord, GreenPoint rigorously complies with ISO 9001:2015, ISO 27001:2013, and ISO 27701:2019 standards.

Marcus Cree

MANAGING DIRECTOR AND
HEAD OF FINANCIAL TECHNOLOGY AND SERVICES

Marcus has spent 25 years in financial risk management, working on both the buy and sell side of the industry. He has also worked on risk management projects in over 50 countries, gaining a unique perspective on the nuances and differences across regulatory regimes around the world.

As Managing Director, Marcus heads GreenPoint Financial Technology and Services and has been central in the initial design of GreenPoint products in the loan book risk area, including CECL and sustainability risk. This follows his extensive experience in the Finastra Risk Practice and as US Head of Risk Solutions for FIS. Marcus has also been a prolific conference speaker and writer on risk management, principally market, credit and liquidity risk. More recently, he has written and published papers on sustainability and green finance.

Marcus graduated from Leicester University in the UK, after studying Pure Mathematics, Phycology and Astronomy. Since graduation, Marcus has continually gained risk specific qualifications including the FRM (GARP's Financial Risk Manager) and the SCR(GARP's Sustainability and Climate Risk). Marcus's latest academic initiative is creating and teaching a course on Green Finance and Risk Management at NYU Tandon School of Engineering.

Sanjay Sharma, PhD

FOUNDER AND CHAIRMAN

Sanjay provides strategic and tactical guidance to GreenPoint senior management and serves as client ombudsman. His career in the financial services industry spans three decades during which he has held investment banking and C-level risk management positions at Royal Bank of Canada (RBC) Goldman Sachs, Merrill Lynch, Citigroup, Moody's, and Natixis. Sanjay is the author of "Risk Transparency" (Risk Books, 2013), Data Privacy and GDPR Handbook (Wiley, 2019), and co-author of "The Fundamental Review of Trading Book (or FRTB) - Impact and Implementation" (Risk Books, 2018).

Sanjay was the Founding Director of the RBC/Hass Fellowship Program at the University of California at Berkeley and has served as an advisor and a member of the Board of Directors of UPS Capital (a Division of UPS). He has also served on the Global Board of Directors for Professional Risk International Association (PRMIA).

Sanjay holds a PhD in Finance and International Business from New York University and an MBA from the Wharton School of Business and has undergraduate degrees in Physics and Marine Engineering. As well as being a regular speaker at conferences, Sanjay actively teaches postgraduate level courses in business and quantitative finance at EDHEC (NICE, France), Fordham, and Columbia Universities.