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MANAGING CLIMATE CHANGE RISKS

MESA DE FINANZAS VERDES DE CHILE

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Climate change is becoming increasingly important in the private and public spheres, leading the world to a context where it is essential to assess climate risks and opportunities

Social context

Concern about climate change has come to the forefront of the collective global consciousness. Climate change responsibility. Reputational risk.

Financial markets

Climate change and sustainability is also becoming a focal point for financial markets. Investors demand greater transparency.

New opportunities

Climate change mitigation and the transition to a more sustainable economy will also bring new opportunities. Rise of new emerging sectors and huge capital investments.

Regulation and standards

Regulators, supervisors and international organizations have been increasingly active in establishing regulation and standards.

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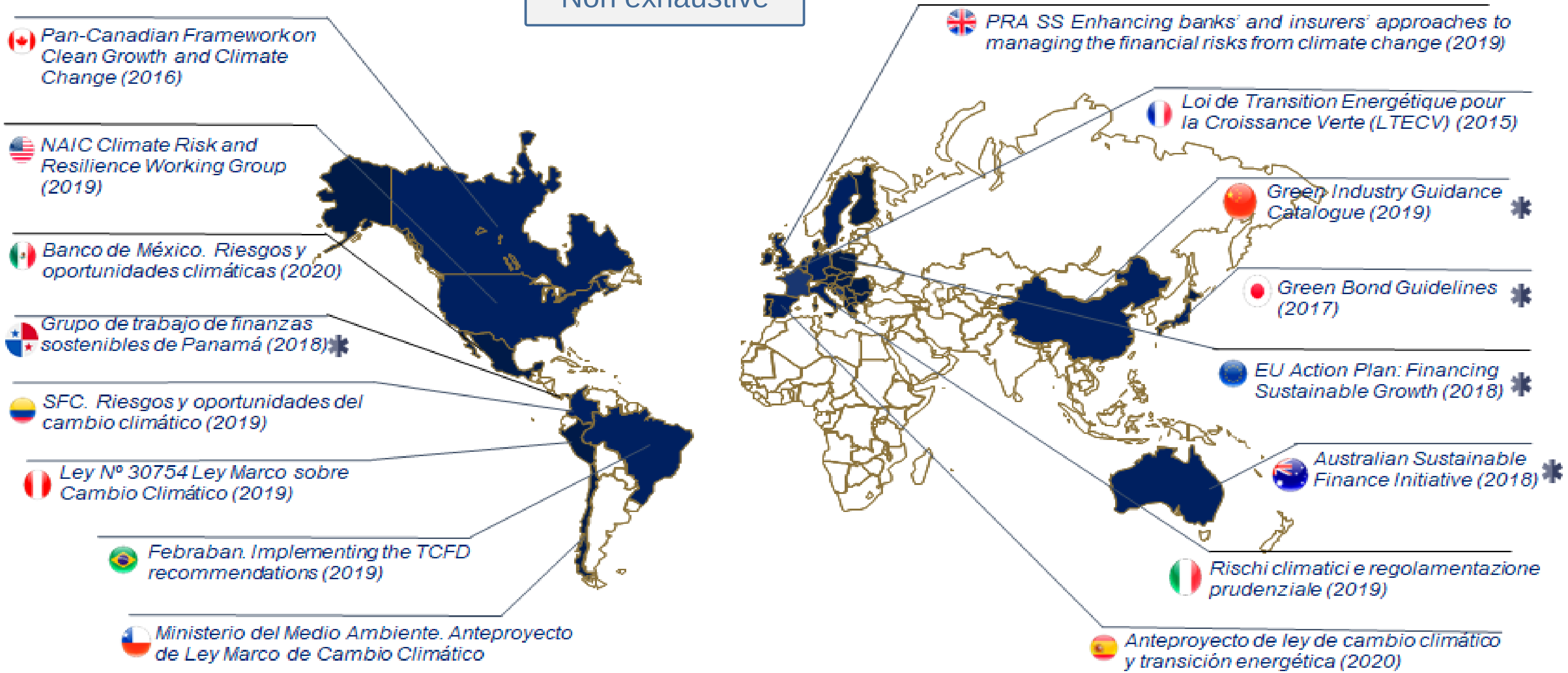
Non exhaustive

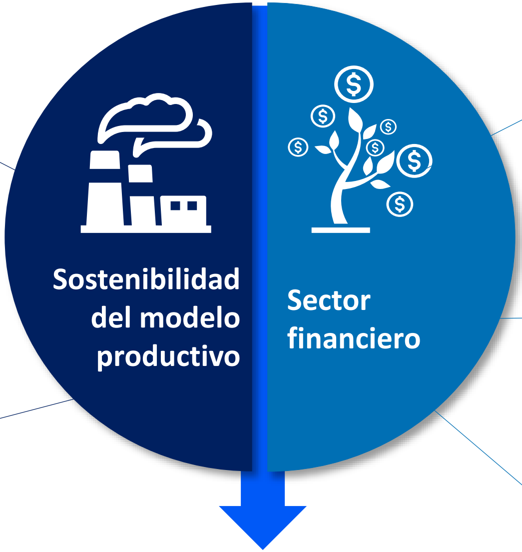


* Iniciativas en el ámbito de la sostenibilidad, no sólo riesgos climáticos

Several trends in financial regulation and supervision around climate risks and sustainability are observed globally

National climate commitments and action plans

Carbon pricing and CO2 emissions markets[1]



Evaluation of the impact of climatic factors on portfolios

Integration of ESG and climate risks in risk management

Analysis of climate scenarios and climate stress test

- Taxonomy of sustainable activities
- Disclosure and transparency

(1) For more information, see the World Bank Carbon Pricing Dashboard. For more information, see the World Bank Carbon Pricing Dashboard.

Climate change risks can be divided into two main categories: those derived from physical impacts and those derived from the transition to a low carbon economy

Physical risks

Derived from the increasing severity of extreme weather events or from long-term changes of the climate

Subcategories of physical risks:

- **Acute risks:** those caused by extreme weather events whose frequency and intensity would increase due climate change.
- **Chronic risks:** those that result from medium or long-term changes in climate behavior, especially due to a general increase in temperatures.

Transition risks

The transition to a decarbonized production system implies a drastic transformation of the global economy, which carries significant risks for companies

Subcategories of transition risks:

- **Regulatory and legal risks:** arising from political and regulatory action which seeks to limit the activities that contribute to climate change.
- **Technological risks:** arising from innovation and improvements which help transition to a low-carbon economy.
- **Market risks:** arising from changes in supply and demand as climate criteria are taken into account.
- **Reputational risks:** arising from changes in perception of certain activities and economic sectors.

Climate risk management may be organised in four key pillars: strategy, governance, risk management, reporting and disclosure

- **Business environment and risk identification**: identify material risks and understand their impact in the short, medium and long term.
- **Business strategy**: integrate material risks in the business strategy.
- Develop a **Strategic Action Plan.**
- **Sustainable finance:** develop a sustainable finance strategy.

- **Management body**: consider in the strategy, objectives and risk management framework, and oversight.
- **Risk appetite**: explicitly include.
- **Organisational structure**: assign responsibility following 3 LoD.
- Assign sufficient **people and resources.**

- **Reporting to the management and governing bodies:** criteria, metrics, data and target setting.
- External **disclosure** standards**.**

- **Climate Risk management framework.**
- **Measuring:** methodologies and tools.
- Consider within **credit, operational, market and liquidity** risk.
- **Impact on capital**: ICAAP, Pillar II.

Climate risk management involves comprehensively reviewing the financial and non-financial risk management frameworks, specially for credit, market, non-financial and liquidity risks

Credit risk

Integrate in the admission and monitoring process:
- Impact on PDs.
- Review rating models.
- Identification of exposures under various scenarios.
- Impact on collateral valuation.
- Review of pricing of operations.

Market risk

Monitor the effect of climate risk on positions and future investments:
- Incorporation at least in Debt, Equity and "equity-related" instruments.
- Incorporation in FOREX and commodity positions.
- Review of credit spreads.
- stress test tools.

Non-financial risk

- Review of business continuity plans.
- Review of recovery plans.
- Impact on reputational risk.
- Impact on liability risk.
- Compliance risk review.

Liquidity risk

- Incorporation into liquidity risk management.
- Incorporation into buffer calibration.
- Forward-looking evaluations, considering both BAU situation and stress conditions.

Scenario analysis and stress test

- Incorporation in ICAAP.
- Scenarios on physical (IPCC or IEA) and transition risks.
- Various temperature scenarios and timeframes.
- Impacts in the recovery and resolution scenarios.

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MANAGEMENT TRAINING DAY 2020

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Thank you!