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Against the motion – “Factoring Climate Risk in Institutional Finance would impede growth in developing country like India”.

The Earth’s surface temperature has risen at a record pace in recent decades, creating risks to life, ecosystems, and economies. Researches point out that further warming is unavoidable over the next decade, and probably after that as well. Global emissions are increasing fast, making climate change a far bigger reality than one could ever imagine.

India’s per capita CO2 emission for 2020 stood at 2.16 tons. As an out turn to climate risk, India alone lost over 80 billion dollars in economic losses over two decades (2000-2019). Hence, there is a need to realize that businesses, investors, and financial institutions need to be more proactive in integrating climate risk considerations in their operations.

The financial risks stemming from climate change arise through two main channels: physical risk and transition risk. Physical risks transpire due to the physical effects of climate change such as extreme weather conditions, changes in sea levels, melting of glaciers, etc., whereas transition risks result from various policy, legal, technology, and market changes that make one shift to a low carbon economy.

And if not addressed and tackled efficiently, these risks can impact the macroeconomic performance of a country and as a consequence increase the cost of capital for investing in that country.

Climate risk hedging has become an investment consideration impossible to ignore. As related disasters and economic losses grow, regulators increasingly recognize it as a systemic financial risk, and in a developing country like ours, these climate risks and events have a direct bearing on the economy and financial system including banks.

Climate shocks can destroy crops, livestock, and other productive household assets. The risk of such shocks can induce households to pursue livelihood strategies that constrain wealth accumulation.

India is an agriculture-based economy. Increased temperatures from climate change are expected to reduce the yields of the four crops humans depend on most—wheat, rice, corn, and soybeans. Moreover, climate change would induce extreme events such as droughts, floods, and storms that destroy, among other things, crops and agro-infrastructure, and if the uncertainties arising out of climate changes are not factored in, the lives of thousands of people depending upon agriculture would be badly impacted. This situation can further induce poverty crises in the country. To tackle such a situation, the govt would have to launch new programs or schemes that will only add to the govt expenditure.

Insurance agencies are the key actors and have a major role to play in supporting climate risk mainstreaming. The majority of the agencies are aware of climate risk pricing and even have products to support climate risk pricing. The International Association of Insurance Supervisors (IAIS) has proposed a framework for assessing and mitigating climate risks. They have also

identified channels for transmitting the sources of the risks to the broader economy and they include the asset liquidation channel, (ii) exposure channel, and (iii) critical functions channel.

Climate risk drivers may also impact banks' liquidity risk directly, through their ability to raise funds or liquidate assets, or indirectly through customers' demands for liquidity. Some evidence suggests that post-disaster lending has a significant and negative effect on liquidity buffers. Severe natural disasters can trigger a sharp increase in precautionary demand for liquidity by financial institutions, households, and corporates and the central bank may have to intervene in order to preserve financial stability. It is therefore critical to connect environmental projects with capital markets and investors and channel capital towards sustainable development. Tackling this immense challenge requires global cooperation. Green bonds are the way to make this connection.

The green bond issuance in India in 2021 was exceptional with the issuance amounting 6.11 billion dollars and is to set a new record in 2022.

Considering the adverse consequences that climate risk possesses, it is prudent for financial institutions to price climate risk in their long-term strategies to protect themselves from uncertain financial losses and ensure the stability of the financial system.

Some of the possible financial impacts could be-

- 1) Income risk that is revenue losses or additional capital expenditure.
- 2) Financing risk, that is the impact on the cost of capital/ ability to access funds, increased insurance costs.
- 3) Credit risk- that impacts countries like India most where the small farmers are unable to return their debt or the value of their collateral depreciates.

While the Financial industry is varied in its functions and specific activities, all agents have in common a fiduciary duty to act in the best interests of the individuals or organizations whose assets they are responsible for overseeing. Some financial institutions recognize that climate change increases uncertainty and investment risk, whilst also producing new opportunities. Managing these risks and capturing new opportunities is therefore crucial if the industry is to carry out its functions successfully.