Why Financial Institutions Should Take Action

In recent years, more and more focus has been placed on preventing and mitigating the effects of climate change. An increasing number of climate-aware investors are shifting their portfolios to include assets backed not only by low carbon and climate resilient activities, but also by data and transparency. Even though "there is a growing community of financial institutions taking action and demonstrating leadership on climate change,"[1] banks are still not doing enough to include climate change in their long-term business strategies and risk management processes.[2] In fact, no bank has disclosed a comprehensive carbon footprint analysis. But why should financial institutions care in the first place?

1. **Climate change poses a significant risk to a bank's operations and portfolios**
   The impacts of climate change have a direct impact on the performance of bank's portfolios, especially with respect to real estate, infrastructure, and agricultural businesses. With global temperature and extreme climate events such as wildfires, droughts, and floods on the rise, the cost of maintaining properties and growing crops are skyrocketing. This has rippling effects throughout the supply chain, leaving other sectors of the economy susceptible to the physical effects of climate change. As a result, banks face the significant risk of higher default rates and increasing devaluation if they do not start taking action to address the operational and portfolio exposure to climate change.

2. **Shifting investor preference of sustainable practices**
   Investors are increasingly moving capital to fund sustainable practices and technologies. Simultaneously, as a result of consumer demand for decarbonization, corporations are leaning towards green solutions. The overall eroding value of fossil fuel heavy practices opens up new opportunities for financial institutions in the sustainable investment space. For instance, banks can incorporate climate-change analysis into underwriting or even directly underwrite green bonds that finance climate change adaption projects. To address investors, financial institutions should deliver a consistent and credible firm-wide climate-advisory story to key stakeholders.[3]

3. **Increasing government policies on sustainability**
   As governments are racing to meet the 2050 goals set by the Paris Agreement, an increasing number of climate policies are being rolled out. This puts more pressure on financial institutions to reduce investment into fossil fuel heavy assets and transition to more sustainable investments.

To conclude, Since the banking industry is deeply involved with financing and investing activities that have rippling effects throughout the economy, it is imperative that financial institutions take action now to develop a holistic climate change strategy to protect themselves against operational and regulatory risks.

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[1] https://www.unepfi.org/fileadmin/documents/FinancialInstitutionsTakingActionOnClimateChange.pdf
[2] Boston Common (2015), "Are Banks Prepared for Climate Change", Impact Report
[3] https://www.ey.com/en_gl/banking-capital-markets/ten-ways-fis-can-address-climate-related-risks-and-opportunities