



Putting environmental scenario analysis into practice

Dr Nina Seega
10th April 2018

Agenda

- 09.00 **Environmental risk analysis in the Mexican context**
- 11.00 **Coffee**
- 11.30 **Physical sources of financial risk. Group work on physical sources of financial risk**
- 13.30 **Lunch**
- 14.30 **Transition sources of financial risk. Group work on transition sources of financial risk**
- 16.00 **Coffee**
- 16.30 **Group work on transition sources of financial risk**
- 17.30 **Wrap up**

Welcome and introduction to the project

Andrew Voysey, Dr Nina Seega

CISL: A unique Cambridge institution

25+ years of building strategic leadership capacity to tackle critical global challenges

60 staff in Cambridge, Brussels, Cape Town

Patron:
HRH The Prince of Wales

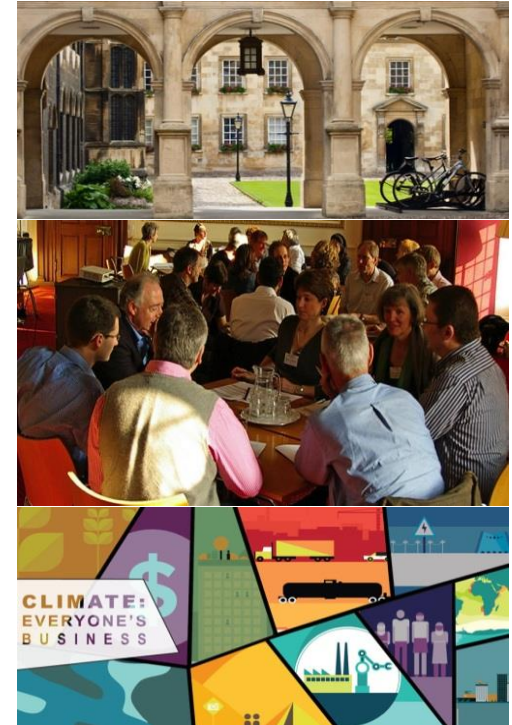
Active network of more than **7,000 members**

Executive and graduate education

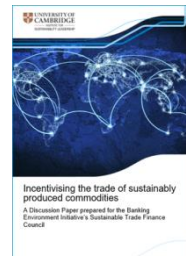
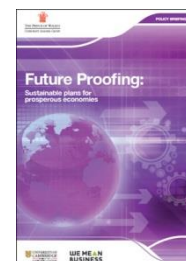
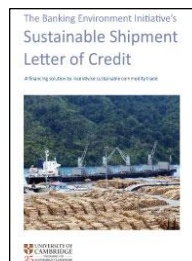
Business and policy leaders groups

- Low carbon transformation
- Sustainable finance (banking, insurance, investment)
- Resource security

Independent research



CISL: Sustainable Finance thought leadership



University of Cambridge Institute for Sustainability Leadership team

Dr Nina Seega, Research Director, Sustainable Finance

Andrew Voysey, Director, Sustainable Finance

Embedding environmental scenario analysis in financial decision-making

Aim: improving the integration of environmental risk into financial decision-making in South Africa and Mexico.

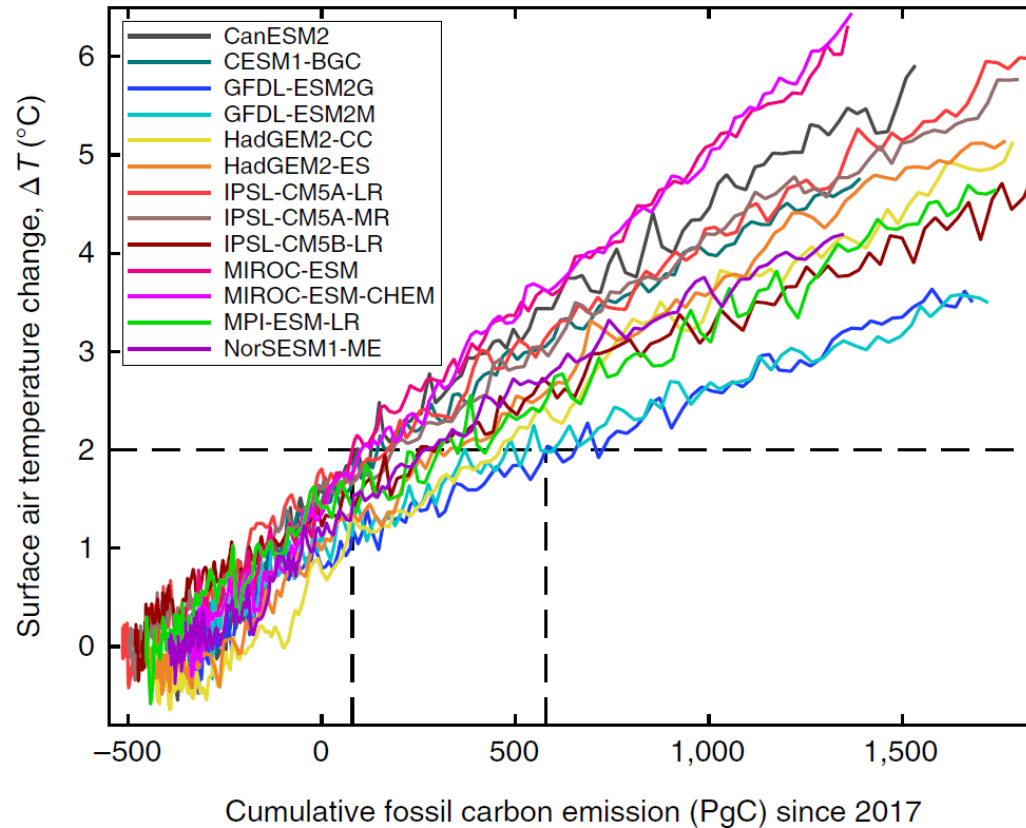
Project partners in Mexico: University of Cambridge Institute for Sustainability Leadership, GIZ, Banxico, ITAM.

Output: tailor-made primers for the South African and Mexican regulators and financial firms on how to develop environmental scenario analysis relevant to their own national contexts.

Timeline:

1. Initial research and design
Dec 2017 - Feb 2018
2. Test thinking in country contexts
Mar-May 2018
3. Final research and design
Jun-Aug 2018
4. Launch and dissemination
Sep-Nov 2018

Embedding environmental scenario analysis in financial decision-making



Greening the financial system

“Environmental risks and opportunities” are not new.

But they (and our exposure to them) are changing in profound ways: scale + likelihood + interconnectedness = materiality and complexity.

Are mainstream tools and techniques keeping up?

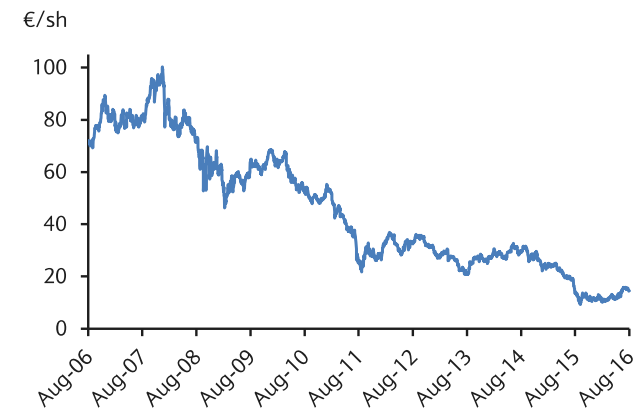
1. Managing risk is central to the safety of firms and the stability of the financial and economic system.
2. All capital is deployed on the basis of expected “risk-adjusted” returns.

E.ON share price over, August 2006-to date



Source: Datastream

RWE share price, August 2006-to date



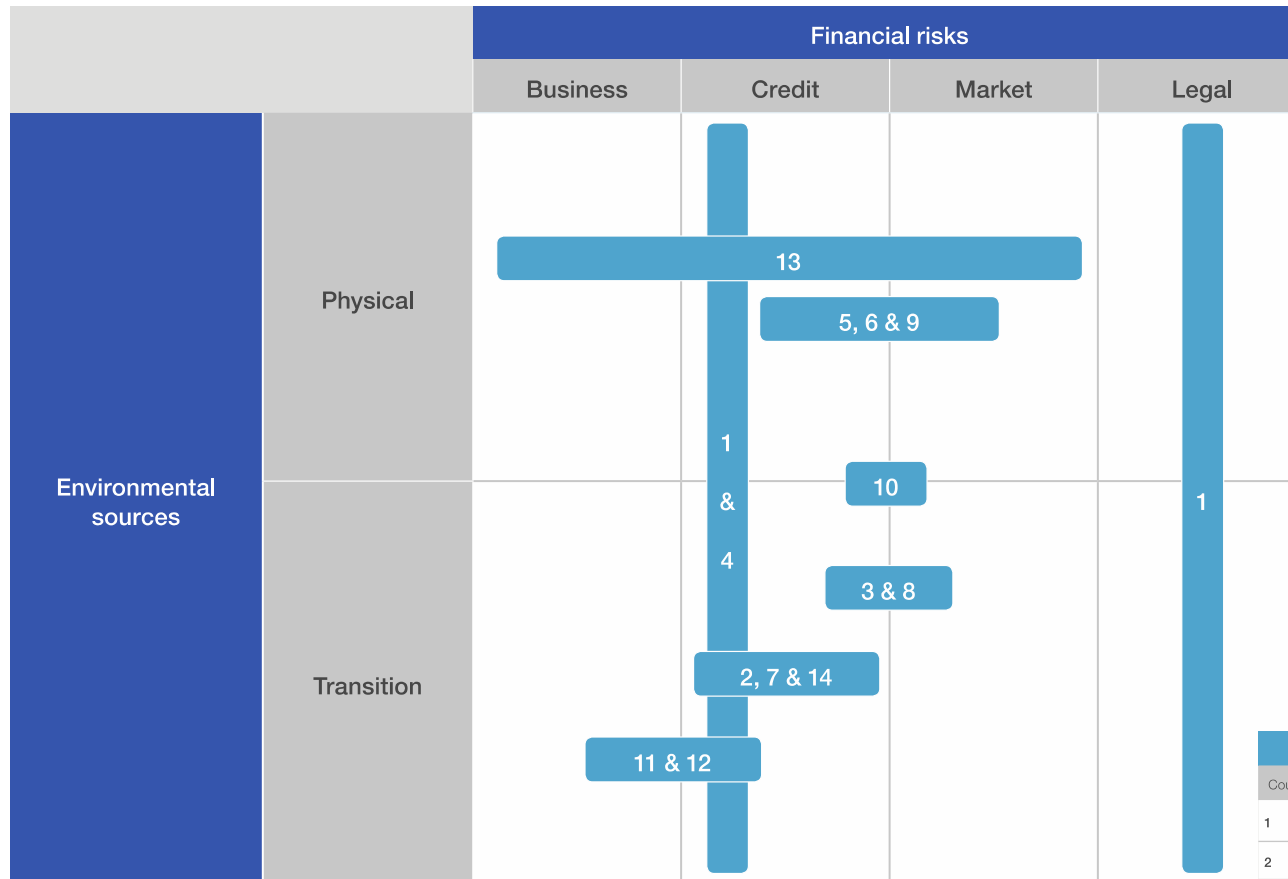
Source: Datastream

Source © Barclays “Scoping the ‘Tragedy of the Horizon’” 1st September 2016

The link between environmental sources of risk and financial risks

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Case studies of environmental risk analysis by financial institutions



Key			
Country	Sector	Country	Sector
1 Brazil	Banking	8 Netherlands	Financial sector
2 China	Banking	9 South Africa	Insurance
3 Germany	Investment	10 Switzerland	Banking
4 India	Banking	11 United Arab Emirates	Banking
5 International	Ratings agency	12 United Kingdom	Banking
6 International	Banking & investment	13 United Kingdom	Insurance
7 Italy	Banking	14 United States	Banking

Scenario-based approaches in orange



Physical sources of financial risk

Dr Nina Seega, Makaio Witte

Global: measuring the impact of physical sources of risk on sovereign debt ratings

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation	S&P Global Ratings and Swiss Re
Geography	Expertise from across Europe, applied globally
Financial Sector	Insurance and credit rating agencies
Environmental source of risk	Physical
Tools or approach used	Probabilistic modelling, with sovereign credit risk analysis
Motivation	Investigation of possible credit and market risk

South Africa: Understanding the impact of climate change on a locality in South Africa

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation	Santam
Geography	South Africa
Financial Sector	Insurance
Environmental source of risk	Physical
Tools or approach used	Scenario analysis and systems models
Motivation	Investigation of possible credit and market risk

Switzerland: Stress testing balance sheet and client vulnerability to climate change risks

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation	UBS
Geography	Switzerland, applied globally
Financial Sector	Banking
Environmental source of risk	Physical and transition
Tools or approach used	Top-down balance sheet stress testing as well as bottom-up stressing of targeted sectors
Motivation	Management of climate-related risks, on behalf the bank and its clients, as part of a broader climate change strategy

Group work physical sources of financial risk

Dr Nina Seega, Andrew Voysey

Group work on physical sources of risk

12.00 – 12.30 Fill out questionnaire

12.30 – 13.15 Discussion about material physical risk scenarios and challenges of using environmental scenario analysis

13.00 – 13.15 Check in with the group

Transition sources of financial risk

Dr Nina Seega

Netherlands: The Dutch Central Bank's review of sectoral exposure to energy transition risks

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation	Dutch Central Bank: De Nederlandsche Bank ('DNB')
Geography	Netherlands, Investment and Insurance
Financial Sector	Banking
Environmental source of risk	Transition
Tools or approach used	Regulatory strategic review, supported by industry exposure data
Motivation	Analysis of sector wide vulnerability to transition risks

China: Stress testing the impact of environmental factors on a Chinese commercial bank's credit risk

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation	Industrial and Commercial Bank of China (ICBC)
Geography	China
Financial Sector	Banking
Environmental source of risk	Transition
Tools or approach used	Stress test
Motivation	Impact of environmental factors on credit risk

Germany: understanding the impact of transition sources of risk on equity valuation

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation

Allianz Global Investors and Allianz Climate Solutions

Geography

Germany, with international application

Financial Sector

Investment

Environmental source of risk

Transition

Tools or approach used

Firm-level modelling of carbon- and energy-regulation under different scenarios

Motivation

Evaluation of carbon risk in equity analysis and valuation

Global: understanding the impact of changes in climate change sentiment on investment portfolios

		Financial risks			
		Business	Credit	Market	Legal
Environmental sources	Physical				
	– Climatic				
	– Geologic				
	– Ecosystems				
	Transition				
	– Policy				
	– Technology				
	– Sentiment				

Organisation	University of Cambridge
Geography	International
Financial Sector	Investment
Environmental source of risk	Transition
Tools or approach used	Oxford Economics GEM
Motivation	Analysis of the impact of sentiment change on investment portfolios

Group work on transition sources of financial risk

Dr Nina Seega, Andrew Voysey

Group work on transition sources of risk

15.00 – 15.45 Discussion about specific Mexican challenges in transition to a low carbon world

15.45 – 16.00 Check in with the group

Group work on governance and disclosure

Dr Nina Seega, Andrew Voysey

Group work on governance and disclosure

16.30 – 17.15 Discussion about the support required from industry, regulatory actors and academic community

17.15 – 17.30 Check in with the group

Wrap Up

Andrew Voysey

Thank you!

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