Mainstreaming Climate in Financial Institutions

Strategic integration of transition risks and opportunities:
how can scenario analysis help?

WORKSHOP

Friday 17th June – 13:00-14:30 CEST

Active participation is very much welcome!

Mute your microphone, when you are not speaking

Switch on your camera if you can

Raise your hand or use the chat to signal that you wish to speak

Recording
The workshop is being recorded.

Any problems or questions? Send a message via the chat function or an email to sarah.bendahou@I4CE.org or alice.pauthier@I4CE.org

Agenda

- **Presentation of the publication "Scenario analysis of transition risk in finance – towards strategic integration of deep uncertainty"**, Romain Hubert, Project Manager, I4CE
- Q&A on the presentation
- Discussants:
  - **David Carlin, UNEP FI**
  - **Sonia Sanz Asensio, Santander**
  - **Camille Laurens-Villain, Caisse des Dépôts (France)**
- Q&A / Experience sharing

“Scenario analysis of transition risk in finance – towards strategic integration of deep uncertainty”

Romain Hubert, Project Manager, I4CE

Q&A on the presentation

Discussion:

- David Carlin, UNEP FI
- Sonia Sanz Asensio, Santander
- Camille Laurens-Villain, Caisse des Dépôts (France)

Q&A on presentations

Experience sharing *(chatham house rule)*

- Have you considered or experienced scenario analysis of transition risks? What was the objective?
- Have you considered other approaches than scenario analysis? Why?
- How have you organized the scenario analysis process (internal dynamics; potential reliance on service providers)?
- How can it help with the strategic integration of transition risks and opportunities?
- How can it be articulated with Paris alignment strategies?

Mainstreaming Climate
in Financial Institutions

Thank you.

www.mainstreamingclimate.org

06/17/2022

Scenario analysis of transition risk in finance: Towards strategic integration of deep uncertainty

Webinar of the *Mainstreaming Climate Action in Financial Institutions* initiative

Romain Hubert – I4CE, Project manager

With the contribution of
the European Union
LIFE program

Context: Guidance is needed to help financial actors take full ownership of scenario analysis of transition risk

Disclosure frameworks

- TCFD disclosure - Strategy c)
- Disclosure requirements

Mixed results so far

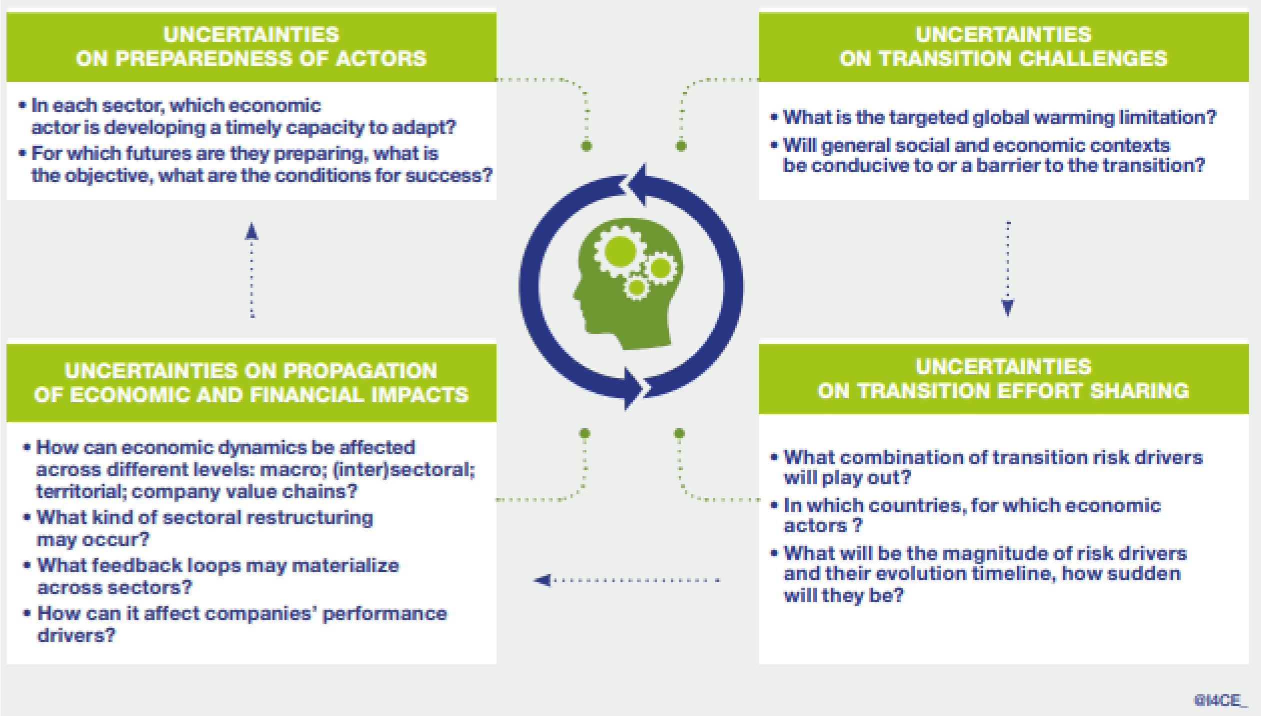
- Profusion of services with technical issues and limited transparency
- Financial actors disclose patchy information on scenario analysis and its strategic use

Moving forward

- Clarify what should be done to ensure strategic relevance of the exercise

Financial actors face strategic risks and opportunities from the low-carbon transition that are complexified by “deep uncertainty”

- Transition risks and opportunities arise in a context of “**deep uncertainty**”

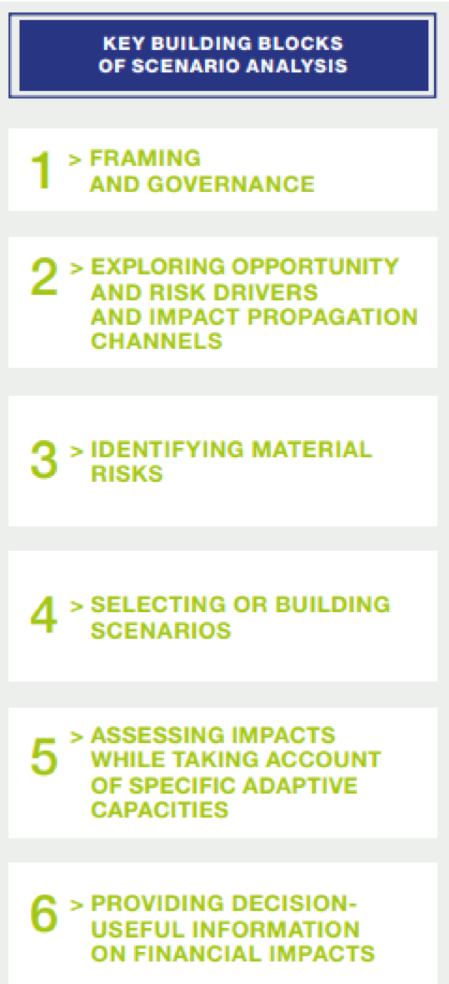


- Financial actors are not inherently equipped to factor in this key characteristic of transition risk

The added value of a strategic integration of deep uncertainty through scenario analysis

- Financial actors' **strategy** can **benefit from the exploration** of deep uncertainty **without predicting the future** or ranking potential futures

- **Scenario analysis** can be used **to organize** the strategic integration of deep uncertainty by:
  - efficiently structuring the exploration effort of potential future complex dynamics
  - enabling financial actors to reshape their internal processes and rationales to take advantage of information on equally plausible alternative futures



Clarifying what should be done in each building block

- Some **principles** for a scenario analysis implementation leading to proper integration of transition risks and opportunities in financial actors’ strategy
- Principles identified **based on a range of sources** including the review of available services
- The list is not necessarily exhaustive
- A **checklist** to review the principles in each building block >>

1. FRAMING AND GOVERNANCE
Involve all relevant teams to ensure the process leads to strategic integration of deep uncertainty
- Identify internal coordinators for the scenario analysis process and build their capacity
- Identify key teams to involve (Managers, ESG, Risks, etc.) and diagnose internal capacities and needs
- Tailor a scenario analysis plan that involves key teams to address their needs and use their capacities with the objective of fostering strategic integration of deep uncertainty

2. EXPLORING OPPORTUNITY AND RISK DRIVERS AND IMPACT PROPAGATION CHANNELS
Build understanding of complex propagation channels of transition impacts in the real economy
- Explore propagation of impacts through the real economy, without forgetting direct impacts on financial actors
- Explore transition dynamics and implications from long to short term with a forward-looking mindset
- Identify uncertain evolutions as well as heavy trends
- Consider a range of risk drivers (policy, technology, behaviors) and financial vulnerabilities in economic sectors
- Include all levels of propagation (sectoral; cascading effects across sectors; macro; feedback effects over time)

3. IDENTIFYING MATERIAL RISKS
Focus efforts on essential areas for further assessing the financial consequences of deep uncertainty
- Explain how the key dimensions of materiality are considered (risk drivers; exposure; vulnerability; time horizon)
- Use a sectoral approach to appreciate exposure and vulnerability
- Consider combinations of risk drivers that are relevant for the sectors under analysis
- Consider several transition dynamics from long to short term, including disorderly transitions

4. SELECTING OR BUILDING SCENARIOS
Handle overwhelming range of potential transition futures by identifying a subset of relevant transition scenarios for assessing impacts on the targeted system
- Understand what drives the multiplicity of transition dynamics and the resulting scenarios
- Include disorderly transition scenarios to highlight challenges from short to long term
- Use scenarios representing targeted financial impacts with sectoral and country granularity & relevant time step
- Update scenarios regularly with recent observations and emerging trends
- Limit subjective choices by building on scenarios developed with public authorities for financial risk assessment

5. ASSESSING IMPACTS WHILE ACCOUNTING FOR SPECIFIC ADAPTIVE CAPACITIES
Integrate complex dynamics at asset-specific level to appreciate specific risks and opportunities and assess net financial impacts
- Analyze transition challenges at level of counterparty: its country and activity exposures; transition stage; anticipated lock-ins; business and competitive environment; issues from a range of key scenarios
- Integrate the counterparty's capacity to address its challenges: potential solutions; resources; resilience strategy (consistency with overall strategy; feasibility; targeted domain of resilience; operationalization)

Potentially include financial actors' own adaptive capacity, discussing their transition risk strategy in context of overall business strategy (including Paris alignment strategy)

6. PROVIDING DECISION-USEFUL INFORMATION ON FINANCIAL IMPACTS
Develop decision criteria and metrics that demonstrate the added value of information on deep uncertainty when making decisions
- Explore smart decision rationales under deep uncertainty
- Choose a decision rationale and subsequent metrics
- Involve teams in choices above, communicate and monitor how they implement these choices
- Build trust in the approach: keep it state-of-the-art and explain how its boundaries affect the reliability of results

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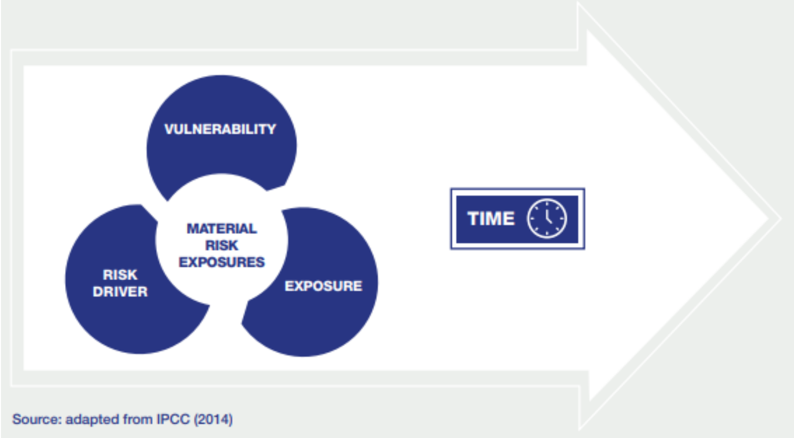
Complete version available here >>
https://www.i4ce.org/download/scenario-analysis-transition-risk-finance/

Technical principals: structuring efficiently the exploration of potential future dynamics and their financial impacts **(1/2)**

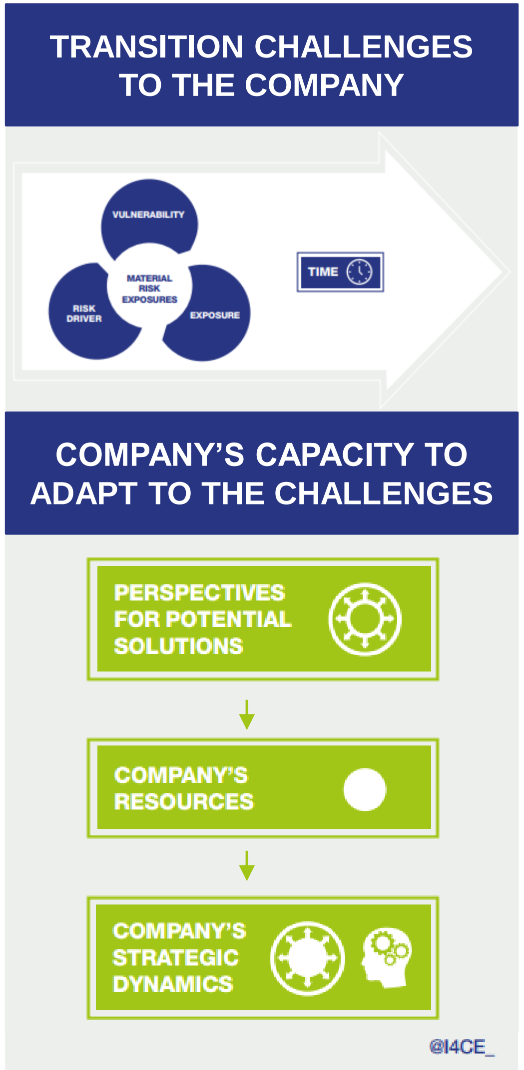
- Dedicate a fair amount of resources to identifying material risks
  - Gain your own understanding of the potential key sectoral dynamics before prioritizing material risks and selecting scenarios
  - Use this exploration work to adapt prioritization criteria



Technical principals: structuring efficiently the exploration of potential future dynamics and their financial impacts **(2/2)**

- Find scenarios that highlight key financial risks and opportunities in selected sectors and countries

- Take account of the range of counterparties' characteristics as much as possible when assessing portfolio financial impacts



Organizational principals: Involve the teams in the whole process to ensure its relevance and internal use

- Involvement of the teams is necessary to ensure the participation of the scenario analysis process in the mainstreaming of transition risk and deep uncertainty in the overall business strategy

- At early stages: organize the mobilization of teams while taking account of their specific context
  - Build capacity of the people in charge
  - Make an initial diagnosis of specific capacities and needs of the team
  - Plan the scenario analysis process accordingly

- The choice of an output metric should arise as the conclusion of internal discussions to select decision-making rationales that are smart under deep uncertainty

How to ensure the implementation of the principles?

- The report takes stock of the implementation of the principles by the existing methodological approaches
- The report proposes actions for a range of stakeholders to make further progress.

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ABOUT THIS WORK

This Work reflects only the views of I4CE – Institute for Climate Economics. Other members of the Finance ClimAct Consortium are not responsible for any use that may be made of the information it contains. The European Commission is not responsible for any use that may be made of the information it contains.

ABOUT THE FINANCE CLIMACT PROJECT

The Finance ClimAct project contributes to the implementation of France’s National Low-Carbon Strategy and the European Union’s Sustainable Finance Action Plan. It aims to develop new tools, methods and knowledge enabling (1) retail investors to integrate environmental targets into their investment choices, and (2) financial institutions and their supervisors to integrate climate issues into their decision-making processes and to align financial flows with energy/climate objectives.

The consortium, coordinated by ADEME, also includes the French Ministry for the Ecological Transition, the Autorité des Marchés Financiers (AMF), the Autorité de Contrôle Prudentiel et de Résolution (ACPR), the 2° Investing Initiative, the Institute for Climate Economics, Finance for Tomorrow and GreenFlex.

Finance ClimAct is an unprecedented programme with a total budget of €18 million and funding of €10 million from the European Commission.

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