

The New Game in Town

BY ANDREAS DOMBRET

*Taking into
account climate
risk in bank risk
management.*

Harvey, Irma, Maria. For most of us, these names immediately ring a bell. They are not last year's most popular names for newborns, but the names of some of the most devastating storms of our time. The Atlantic hurricane season of 2017 was one of the worst in years by various meteorological standards. The same holds for its costs. Reinsurers put the global insurance bill for the hurricanes and other natural disasters that struck in 2017 at US\$135 billion, making it the year with the highest insured losses ever. Total economic losses—including uninsured losses—soared in 2017 to US\$330 billion, the second-highest on record.

Clearly, these extreme weather events, which are unfortunately becoming more frequent and more severe, have serious economic and financial repercussions. They give us an inkling of the price that we could pay for climate change in the future, and of the risks that climate change could pose for financial institutions. The question is: are we doing enough to adequately tackle these risks?

While the costs of Harvey and other storms are already clear for all to see, too little attention is being paid to the ultimate challenge associated with climate change and society's response to it. The fight against climate change can only succeed if economies across the world are transformed into green, low-carbon economies. This transition of the economy will doubtless prompt markets to reassess the value of a broad range of assets. Depending on the speed and orderliness of the transition and the

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**THE INTERNATIONAL
ECONOMY**
**THE MAGAZINE OF INTERNATIONAL
ECONOMIC POLICY**
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Hurricane Harvey caused extensive flooding in a residential area in Southeast Texas, August 2017.

associated repricing process, they could become relevant for the stability of financial institutions as well.

The form that the transition will take hinges to a large degree on climate policy—and there are signs that the likelihood of far-reaching changes in climate policy is growing. The One Planet Summit held in December 2017 in Paris at the invitation of French President Emmanuel Macron, together with the World Bank and the United Nations, sent a

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strong signal that the world community is willing and able to act. Those who thought that the U.S. decision to withdraw from the Paris climate agreement would stop the global push to combat climate change have just been taught otherwise.

Now skeptics might argue that paper doesn't blush. Indeed, it remains to be seen whether all the commitments made will be honored, whether policymakers will live up to the milestone Paris climate accord of 2015, and whether and when the transition to a green, low-carbon economy will happen.

Skepticism tends to prevent action. For financial institutions and other businesses, this stance would result in a wait-and-see approach. But the transition of the economy will happen eventually. What is more, it might happen faster than many stakeholders think. Financial institutions should know that a muddling-through strategy is risky—and that it will not be successful.

Most banks and, to a somewhat lesser extent, many institutional investors have yet to develop the capacity to understand and assess the risks that arise when environmental aspects are factored into the valuation of their assets. Developing these capacities and integrating climate-related risks into their risk management needs to be high on boardroom agendas.

The same holds for financial supervisors. They need to understand all potential threats that climate change and the transformation of the economy could pose for financial institutions. Recognizing this, central banks and supervisors from around the world—including France, Germany, the United Kingdom, China, and others—recently launched the Central Banks and Supervisors Network for Greening the Financial System. The network will serve as a platform to exchange views and best practices with regard to climate-related risks for the financial sector. It will help strengthen the global response to the challenges stemming from climate change and enhance the ability of the financial system to manage these risks appropriately. ◆