Financial Services Forum
Reimagine The Future

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Actuaries Institute

SYNOPSIS

CLIMATE RISK AND AUSTRALIA'S FINANCIAL SYSTEM

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Key words: Climate Change, Stranded Assets, Investment, Regulation, Systemic Risk

Purpose of your paper: How will climate change affect Australia's financial system in the future? We explore where financial institutions will be impacted by identified climate change risks, how well existing safeguards may address these risks, and what further actions may be required.

Drawing on studies and regulatory decisions from Australia and overseas – including the recent paper from the Bank of England – we set out why climate change deserves careful consideration from Australian financial institutions and regulators.

Synopsis: Our presentation will be based on

- the recent paper by The Climate Institute: http://www.climateinstitute.org.au/articles/publications/australias-financial-system-and-climate-risk.html/section/478

- the recent paper by the Bank of England: http://www.bankofengland.co.uk/pra/Documents/supervision/activities/pradefra0915.pdf

Key points

Broad categories of climate financial risk:

- Physical risk, where assets are damaged or devalued as a result of climate change itself
- Transition risk, which includes financial exposure to the risk of carbon emissions or carbon-intensive assets being priced, regulated, stranded by technology, or incurring legal risk
- Liability risk, which includes financial liabilities arising out of the above

How climate risk may originate:

- Efforts to avoid climate change, including domestic, foreign and international policy measures
- Shifting demand for carbon-intensive exports
- Shifting investor appetite for carbon intensive assets
- Fiscal risk from unfunded public contingent liabilities arising from the effects of climate change
- Uninsured or uninsurable assets exposed to increasingly probable catastrophic disasters
- Individuals and institutions are incentivised to ignore risks

Points of transmission and amplification:

How the effects of climate risk may magnify and spread throughout Australia's financial system. These include:

- Australian sovereign debt, if affected by factors including macro outlook changes due to our carbon-intensive economy (transition risk); and fiscal position shifts due to our exposure to climate change itself (physical risk)
- Exposure of Australian banks to carbon intensive assets via their business loan books (transition risk)
- Exposure of Australian banks and parts of the insurance sector to climate impacts via their concentration in residential property & mortgage debt (physical and transition risk)
- Exposure of large superannuation (pension) asset pools, due to concentration in domestic assets of a carbon-intensive, climate impact-exposed economy (physical and transition risk)
- Shortage of low-carbon assets potentially leading to over-inflation of such assets (transition risk)

Information barriers and opacity:

- Scientific climate models are subject to uncertainty; however this is improving
- Information is unevenly distributed, with some key financial agents lacking visibility of climate risk which may expose them to loss
- Both public and private disaster mapping data and modelling is unco-ordinated and difficult to access