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Generating a Competitive Advantage in a Carbon-Constrained Future

What Does it Mean for Business and Capital Markets?

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How is competitive advantage created?

- For any industry, increasing competitive advantage can derive from:
  - Mitigating risks that destroy value
  - Capitalizing on opportunities that create value

- Success hinges on achieving an optimal mix of risk mitigation and opportunity realization

How does a carbon-constrained future affect competitive advantage?

- A carbon-constrained world presents unique risks …
  - Reputational risk
  - Compliance risk
  - Economic risk
- …and unique opportunities
  - Clean-tech
  - Emissions trading
  - Carbon neutralization

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What does this mean for financial institutions?

- Insurers, banks, and other financial intermediaries are not immune to climate change
- For successful FIs, climate considerations will influence all aspects of their business
- Increasingly, climate impacts will affect both sides of their balance sheet

How can FIs climate-proof their balance sheet?

	Assets	Liabilities & Equity
Insurers	✓ Sustainable investments	✓ New "green" insurance products ✓ Efforts to limit climate-related insurance risks ✓ New approaches to deal with catastrophic losses
Banks	✓ New climate-related fee-based business (e.g., fund management, emissions trading) ✓ New "green" financing products	✓ Enhance attractiveness to climate-sensitive investor base

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Insurers can mitigate climate impacts tactically and more strategically

- Allstate recently decided to stop writing homeowners' insurance policies in New York City and Westchester, as well as the (more expected) coastal areas.
- Insurers can promote building codes that encourage water savings and energy efficiency.
- They can promote prudent policies in zoning and land use regulations designed to limit climate-related insurance risks.
- They can explore new approaches (e.g., PPPs) to reserve against catastrophic losses.

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Insurers can pursue new product and service opportunities

- Coverage of uninsured
  - World Bank Caribbean Catastrophic facility is pooling risk for nations that currently don't have coverage
- Weather derivatives
  - Despite current challenges in performing actuarial analysis where future weather patterns may be less predictable than in the past
- Carbon credit delivery guarantees
  - Recent product offering by AIG and the World Bank's IFC

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They can also promote sustainable investment

- This is crucial in order to protect their own reserves, promote practices that will slow down climate change, and fund the development of new climate-related technologies.

- This is evident by the large role of insurers in the Carbon Disclosure Project (CDP):
  - an initiative of 284 of the largest institutional investors with some $41 trillion of assets under management
  - requests the world's top publicly listed companies to disclose their climate impact
  - now in its fifth year of operation

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For banks, climate risks will impact the cost of raising capital

- Until recently, climate policies have been a minor part of a typical bank's broader CSR framework.

- This is changing, as CDP provides peer review and ranking of climate performance:
  - CDP's Climate Leadership Index ranks banks and "diversified financials" around the work
  - Over time, this will increasingly affect the attractiveness of FIs to institutional investors

Meanwhile, attractive opportunities for banks lie in new fee-based business…

- Carbon credit brokering and trading
- Arranging, structuring and advising on carbon financings
- “Green” fund management
  - Clean-tech VC
- “Green” bond underwriting
  - Interest payments linked to carbon credit value
- Carbon derivatives
  - Carbon credit price hedging

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… and risk-based financial products and services

- Financing "green" municipal infrastructure
  - ABN AMRO, Citi, Deutsche Bank, JPMorgan Chase, and UBS have committed (with the Clinton Foundation) to arrange $1 billion each to retrofit cities with more energy efficient technology
  - This is expected to double the global market for building energy retrofits
- Developing new climate-related financing products:
  - Debt service linked to energy costs savings
  - PPPs for brownfield remediation
  - Merging traditional project financing with emerging carbon finance

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In summary

- Financial institutions need to focus on ways to "carbon proof" their balance sheet.

- This will help them build competitive advantage by:
  - avoiding climate-related risks
  - opening up new "green" product and service opportunities