CFRF CLIMATE FINANCIAL RISK FORUM

CFRF roundtable discussion: Implications of the current geopolitical and economic environment on the transition to net zero carbon emissions and the response of the finance industry

This document provides a summary of the discussion held in a CFRF convened roundtable. A summary of this discussion is being shared to highlight some of the issues being considered at the time of the meeting, many of which are likely to remain relevant today. The views set out should not be taken as those of the FCA, PRA or CFRF membership. Nor should the views be taken as a form of regulatory guidance.

Overview

On 29th July 2022, the Climate Financial Risk Forum (CFRF) convened a roundtable discussion on the transition to net zero in light of a number of headwinds - notably those associated with energy. Attendees at the session were drawn from a broad selection of financial firms. It was structured around two key topics: Part 1 - Implications of the current geopolitical and economic environment on the transition to net zero carbon emissions; and Part 2 - How can the financial services industry respond to these challenges?

Part 1: Implications of the current geopolitical and economic environment on the transition to net zero carbon emissions

The full impact of the changing external environment on the transition to a low carbon economy is unclear, with a number of different factors at play. However, attendees made a number of observations:

- Recent events have reconfirmed an expectation that volatility and uncertainty are likely to represent consistent challenges throughout the transition (e.g. volatility in energy prices). To address this, suitable mitigation and adaptation tools will need to be developed and utilised.
- Geopolitical shocks can compound with pre-existing supply and demand issues (e.g. energy prices and demand were spiking before Russia invaded Ukraine). This can exacerbate the challenges that need to be addressed.
- Increased availability of renewables is not yet at a level to offset a reduced investment in traditional fossil fuels. As such, investment in higher carbon energy sources is still necessary.
- High demand and energy prices do, however, give potential for accelerated progress on renewables, demand side measures, and better competitiveness of new clean technology. There is potential for greater climate and energy literacy, and increased self-generation (e.g. rooftop PV and batteries).
- Equally, attendees observed an expected elevated use of coal fired power to plug the demand gap and investment in Liquefied Natural Gas infrastructure. The cost of energy issues for governments could lead to refocusing of net zero ambitions in light of supply & demand issues.

Part 2: How can the financial services industry respond to these challenges?

Adapting scenario analysis to incorporate a disorderly transition

Scenario analysis is an important tool to assess the impact of potential climate pathways, and to continue building the case for change through understanding impacts of both physical and transition risks together. Until recently, many firms' scenario analysis exercises have been conducted on the premise of an orderly transition. Some members suggested that recent events have shown that the transition is less likely to be orderly with a decreased likelihood that an end-century temperature increase close to 1.5°C will be achieved. Under this scenario, related risks would be elevated.

To address this position, there was a broad view that firms' scenario analysis would usefully assume that the transition to net zero will be partially or completely disorderly, and that further geopolitical or climate-related events are likely to require iterative & adaptive adjustments to transition planning.

Attendees felt that a broader range of scenarios would usefully be considered as firms seek to understand the consequences of a disorderly transition for adaptation, mitigation, forecasting and business as usual planning. Such scenarios could include temperature rises greater than 1.5°C, as well as the increased need to divert funds towards crisis management - potentially with the consequence of defunding climate solutions/mitigations etc.

Transition planning

Some attendees felt that firms need to plan for the changes that the transition will bring regardless of their own organisational targets or strategies for reaching net zero carbon emissions. Such planning would usefully include physical risks, and increased litigation risk associated with a failure of duty of care or the lack of a credible transition plan.

Transition planning would usefully factor in potential events which may slow down the pace of transition efforts, allowing firms to better understand how they can chart their own transition through periods of volatility and uncertainty.

Disclosures

Firms noted the need for interlinkages/interoperability between the reporting framework set out by the Task Force on Climate-Related Financial Disclosures (TCFD) and transition plan reporting. Effective, comparable and consistent disclosures were highlighted as being dependent on public and private sector working together to drive reporting progress.

Educating and influencing

Attendees acknowledged the inherent challenges of achieving their own climate commitments while simultaneously balancing other stakeholder and social commitments. There is a clear role for financial institutions to support and educate customers in transitioning their energy consumption, but for such customer engagement to be as impactful as is required, it must be supported by clear government policy and actions. As such, it was asserted by some attendees that financial services should consider how best to influence policy makers in this space.

There were differing perspectives on the role of governments in the role of energy markets, carbon pricing and climate transition. The discussion covered how externalities are valued in firms' business models, noting that net zero and energy transition remain abstract constructs otherwise. There were different perspectives on the role of policy makers in promoting investment in clean sectors – whether market forces should be relied upon, or whether something additional is needed to drive momentum.

Some attendees felt that firms should share their experiences, perspectives and opinions with policy makers and consumers alike to ensure the full diversity of opinions and evidence are taken into account.