

Take5 for business

Volume 13 Issue 8 - 27 September 2024

Building a climate resilient future

Modeling the impact of climate
risks

Building financial resilience to climate-related risks

The rising challenges of global climate change pose wide ramifications for the resilience and stability of economies and organizations worldwide. Consequently, financial institutions (FIs) are accelerating their focus on developing a comprehensive and robust framework for climate risk management. This framework factors and integrates all relevant climate change risks, including their linkages with other risk categories such as market risk, operational risk, credit risk and country risks.

In Malaysia, effective 30 June 2025, FIs will need to identify the potential impact of climate risk on their loan portfolios to ensure organizational sustainability and resilience. Bank Negara Malaysia (BNM) has set the Climate Risk Stress Testing (CRST) modeling assessment methodology for Malaysian financial institutions. This requires reporting the impact of climate risk with quantitative and qualitative modeling to gauge the susceptibility of Malaysia's financial system to climate-related hazards.

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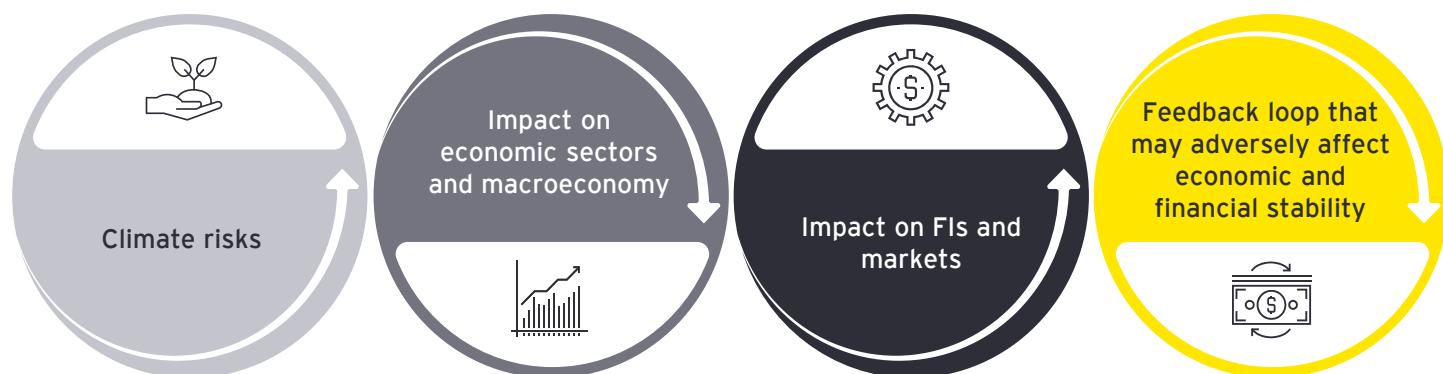
Mitigating the impact of climate change risks and associated financial risks are much driven by Government policymakers and businesses actions or inactions.



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The impact of climate risks to FIs

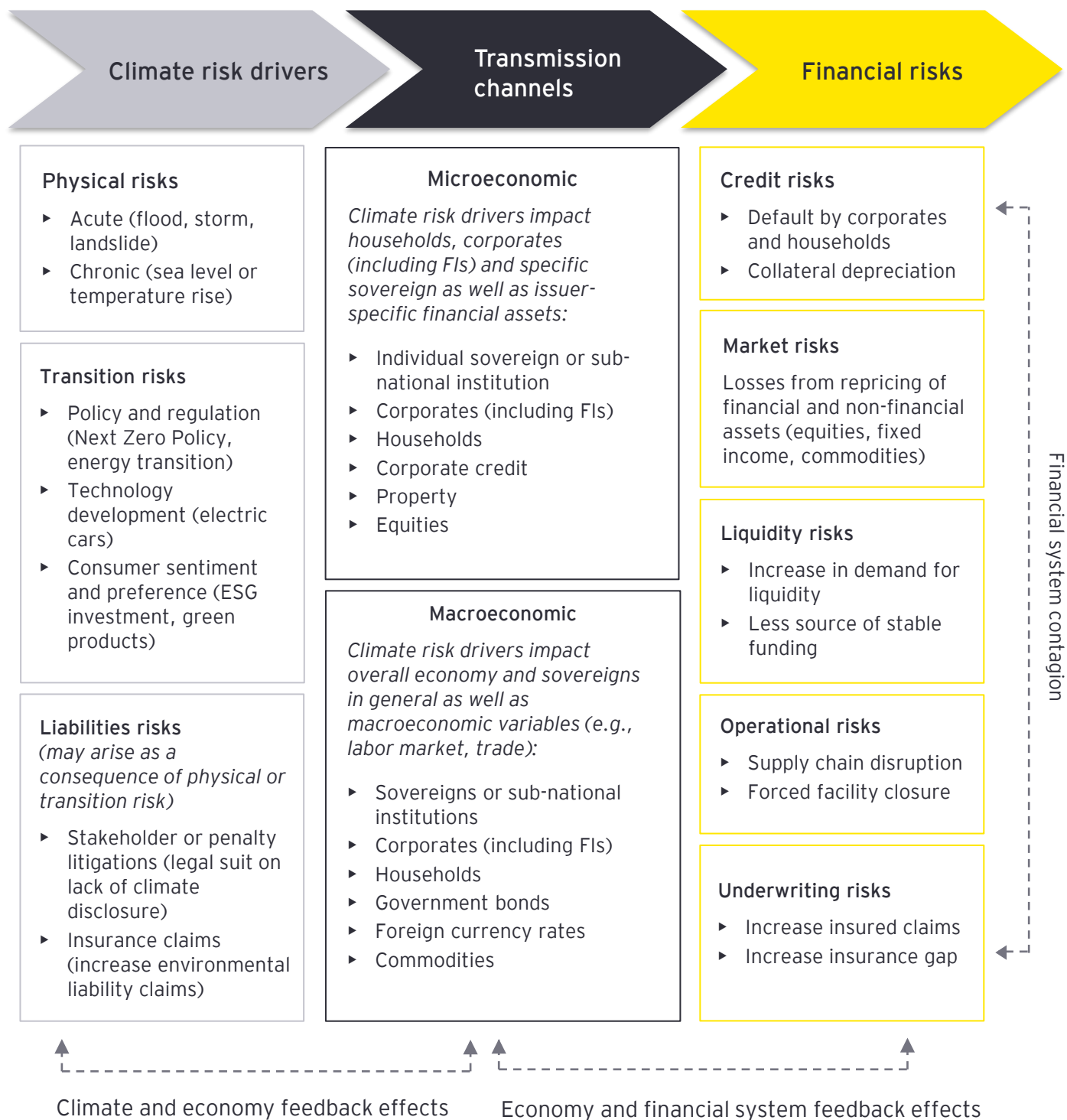
FIs and markets are exposed to climate change through transmission channels that arise from climate risk drivers.



Source: Adapted from *Preparing Our Financial Sector for Risks from Climate Change*, Bank Negara Malaysia, 2021

Transmission of climate risks to financial risks

Climate change is a complex collective issue that pose material risks to the safety and soundness of FIs, potentially implicating the financial stability and sustainable economic growth. Hence, FIs are expected to have an effective risk management framework that integrates all material risks, which includes climate-related risks and their interactions with transition and liability risks as well as their impact on transmission channels aside from the contagion financial impact.



Source: *Climate Risk Stress Testing Exercise: Discussion Paper*, Bank Negara Malaysia, 2024

How FIs can assess the impact of climate risk

In February 2024, BNM issued the Climate Risk Stress Testing (CRST) exercise methodology paper. Financial services institutions in Malaysia are expected to conduct quantitative and qualitative modeling and assessment based on the methodology prescribed by BNM.

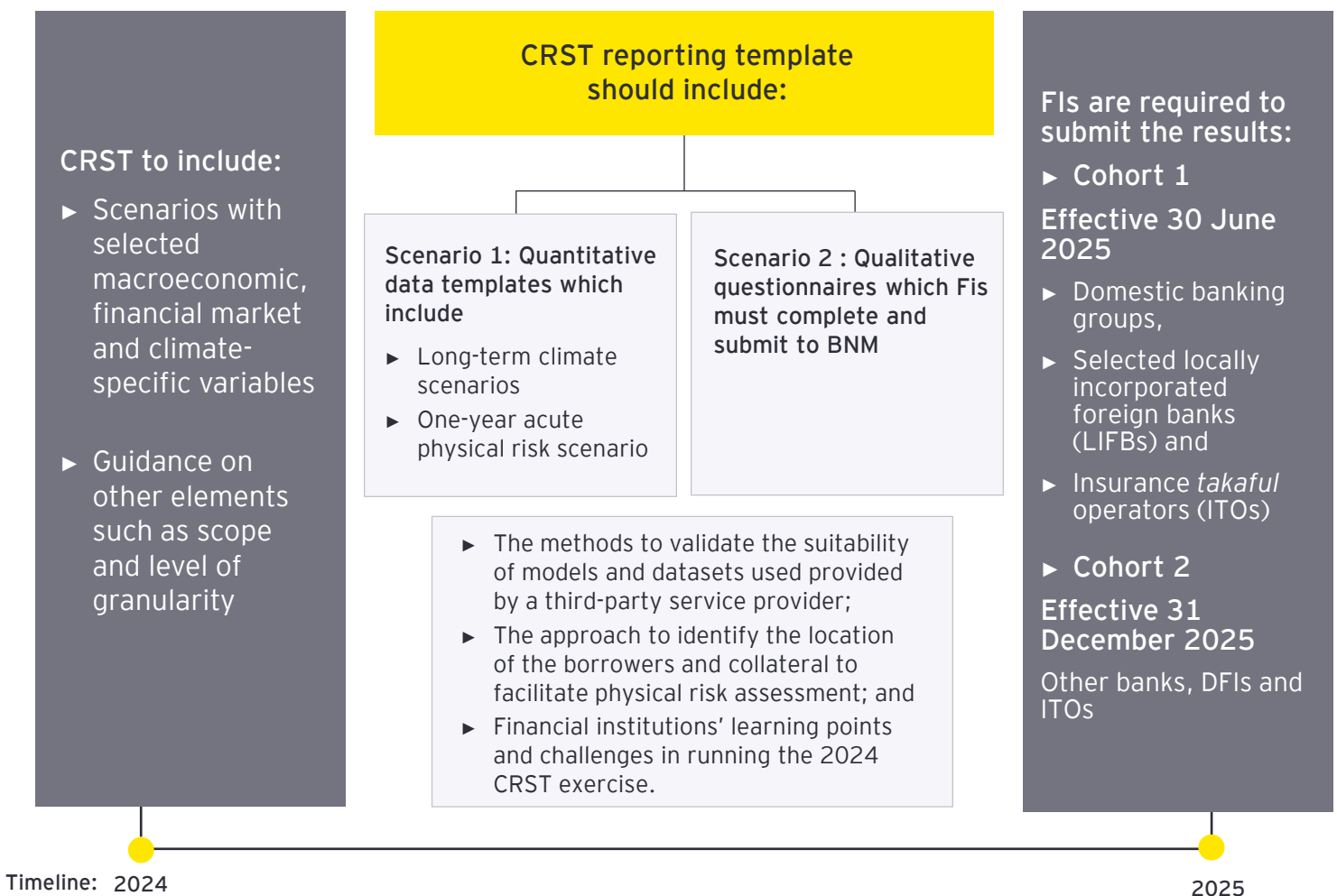
In addition, by 2025, BNM intends to present the findings of the CRST and gauge the susceptibility of Malaysia's financial system to climate-related hazards, as well as its governance and risk management practices.

Applicability of CRST

The CRST is applicable to:

- 1 Conventional and Islamic banks
- 2 Insurers and *takaful* operators
- 3 Development financial institutions (DFIs)

BNM: 2024 Climate Risk Stress Testing methodology paper

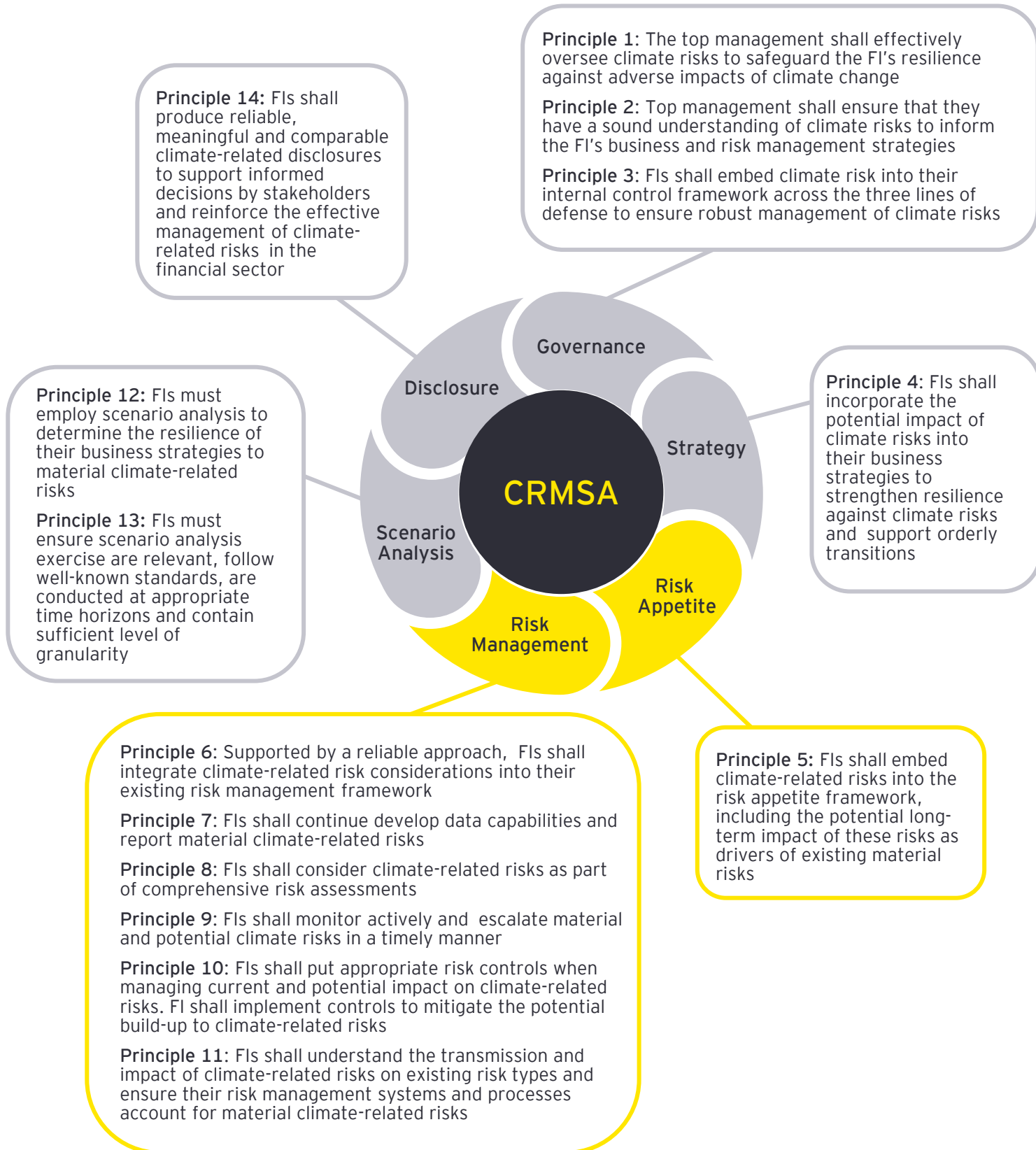


Source: *Climate Risk Stress Testing Exercise: Methodology Paper*, Bank Negara Malaysia, 2024

Key guiding principles

For the CRST exercise, FIs are expected to adopt the principles of climate risk management and scenario analysis (CRMSA), which is guided by 14 key principles, covering areas from governance, strategy, risk appetite, risk management, scenario analysis and disclosure.

BNM: Climate Risk Management and Scenario Analysis

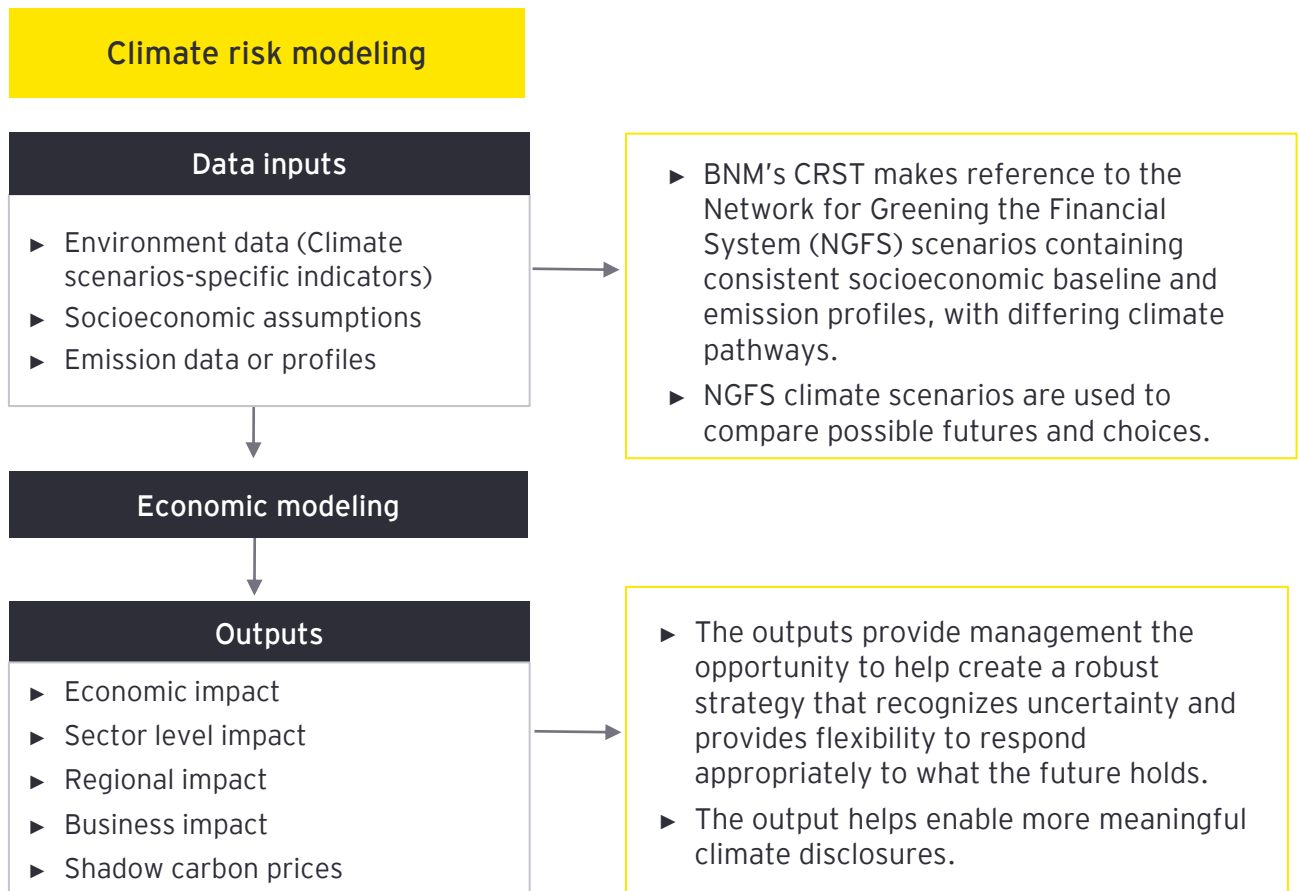


EY Climate Risk Modeling

FIs and businesses can consider utilizing the EY Climate Risk Model (CRM), to navigate the uncertainty of climate risks and understand the impact of different climate transition and physical risk scenarios on their business and investment portfolios.

The EY organization's proprietary CRM tool is a highly versatile model of the global economy with a set of data inputs and outputs as outlined below:

How does the model work?



Source: EY analysis



How can Climate Risk Models help?

The CRM simulates robust scenario testing, including climatic and non-climatic drivers, to facilitate FIs and businesses in evaluating investment decisions, assessing business risks, updating informed regulatory disclosures and providing insights that facilitate the computation of credit ratings and underwriting actions.

Provide informed investment decisions and exclusion policies

Investments

Risk

Facilitate the implementation of stress testing of business plan for management strategies and actions

Climate Risk Models



Allow for quantitative scenario analysis to provide informed regulatory disclosures

Disclosure

Finance

Provide insights into climate adjusted internal credit ratings and life underwriting

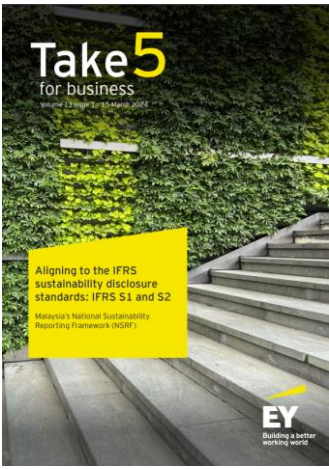
Source: EY analysis



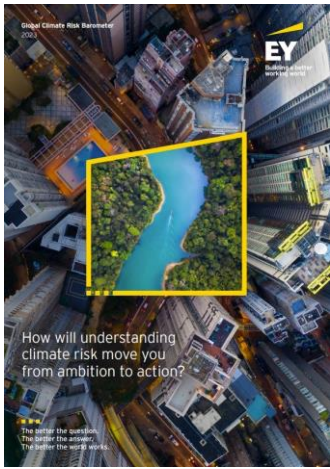
EY thought leadership



A new economy
2024



Aligning to the IFRS sustainability disclosure standards, IFRS S1 and S2: Malaysia's National Sustainability Reporting Framework (NSRF) 2024



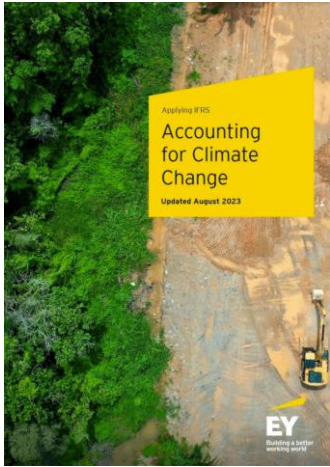
Global Climate Risk Barometer
2023



Renewable Energy Country Attractiveness Index (RECAI)
2024



The green transition
2023



Accounting for Climate Change
2023



C-suite insights: Sustainability and ESG trends index
2023



How can corporate reporting bridge the ESG trust gap
2022

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