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Helping financial institutions to scale up climate change adaptation for increased resilience

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The financing of adaptation measures has not become widespread up to now due to a number of obstacles. These include – but are not limited to – insufficient harmonization of practices and terminology, less harnessing of private and public capital for climate adaptation than for climate change mitigation, and the complexity of climate risk management.

While different obstacles are specific to different segments, the main barriers can be divided into three categories from the perspective of Financial Institutions (FIs) and regulatory/supervisory bodies:

- **Technical and operational capacity gaps in climate risk management practices.** An existing and increasing awareness of climate risks within FIs has yet to be translated into operational risk management practices. This encompasses several factors such as the necessary improvement of the management of physical climate risks, insufficient availability of climate risk data and the general need for relevant decision-making tools.

- **Weak regulatory and policy guidance for the financial sector.** Until recently, financial regulations on climate disclosure and climate risk management have remained below the required level of transparency. With a few exceptions, regulators have made neither adaptation financing nor physical climate risk management central priorities. Consequently, there has not been adequate supervision of financial sector compliance with existing regulations. Combined with the absence of harmonized and robust metrics or standards for measuring the climate resilience impacts of adaptation projects, there is a lack of meaningful disclosure of climate risks.
- **Perceived lack of profitable adaptation finance projects.** The market generally regards adaptation projects as public goods (e.g. the water sector, disaster management etc.) and does not readily invest unless through blended finance approaches as there is no apparent business case. Furthermore, innovative resilience and adaptation technologies may take time to achieve market acceptance and become commercially viable.

Against the background of the afore-mentioned prevailing challenges, GFA supports private and public FIs as well as regulatory bodies **to build up the necessary capacities and frameworks to enable scaling-up of adaptation finance**. To this end, GFA created a specialized Financial Systems Development department. Cooperation with GFA's Climate Competence Centre and dedicated, adaptation relevant technical departments such as Agriculture, Water, Sanitation and Waste Management and Natural Resource Management provide flexible and appropriate responses to the fast-paced climate adaptation finance environment.

GFA'S approaches to bolstering FI involvement in climate change adaptation

In DFI-funded financial sector projects, GFA has successfully participated in:

- **Capacity building in adaptation finance.**

In general, the key to overcoming perceptions of unprofitability is through capacity building and knowledge creation. To this end, it is crucial to promote the success and benefits of climate adaptation projects (e.g. by showcasing innovative pilot projects) to ultimately further project origination. **A good guiding principle is to improve understanding of adaptation projects by addressing their greater complexity when compared to mitigation projects and reducing resulting uncertainties among FIs.** This entails conveying the relevance of key adaptation sectors like water, infrastructure, green building/housing or agriculture as the main priority sectors for adapting to climate change. By accompanying FIs in the assessment of underlying technologies and project concepts (e.g. water reduction technologies for resilient agriculture) and the related impact measurement, calculation and interpretation, the derived insights can be translated into improved origination and implementation practices for adaptation projects.

> *On the Financial Institution side, climate-risk management ideally becomes a core process right across its entire operations.*

- **Improving climate risk regulations and management practices in FIs.**

Thanks to the work of the Task Force on Climate-Related Financial Disclosures (TCFD) inter alia, there is a growing consensus around definitions concerning the types of climate risk (e.g., physical, transition, liability). Nevertheless, interpreting climate risks at the level necessary for financial decision-making often requires expertise not sufficiently available in financial regulatory agencies and FIs. Consequently, regulators (e.g. Central Banks) should be assisted in internalizing taxonomies, reporting and disclosure guidelines and converting these into national legislation. The enforcement and monitoring of these regulations should be accompanied by quantitative and qualitative monitoring tools. **Improving regulators' skills and approaches for climate scenario analyses and overall climate data management can enhance their future capacity to shape the regulatory environment.** On the FI side, climate-risk management ideally becomes a core process right across its entire operations. Ultimately, this means that FIs must have relevant climate risk expertise across key functions, including credit, risk management, portfolio management and investment officers. In this regard, assistance with understanding and deploying climate risk management tools and applying climate risk management and disclosure practices is crucial.

- **Development of adaptation finance products.**

GFA supports FIs in the development of green financing instruments for adaptation finance, such as green bonds or green credits. These products can channel large amounts of private and public capital into sustainable economic adaptation activities. Through these products, investors can finance company's adaptation projects, including investments in sustainable and resilient agriculture and forestry or resilient water supply. **Suitable financial products do not have to be limited to green bonds or credit products but may also include investment funds or (impact) crowdfunding platforms.** Product development should follow a tried and tested pattern that includes market research, determining preconditions, regulatory/legal framework assessment and financial product design. It will also include operating processes, guidelines, reporting and disclosure processes and oversight.

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