

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

“We can’t undo the mistakes of the past. But this generation can make things right. This generation can make the systemic changes that will stop the planet warming, help everyone adapt to the new conditions and create a world of peace, prosperity and equity.

Climate change is here, now. But we are also here, now.

And if we don’t act, who will?” *(IPCC 2018)*



ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

Recent years have witnessed a **'transition in thinking' on climate change as a core financial issue.**

Started at the ideas - Stern, N (2006), 'The Economics of Climate Change: The Stern Review', Cambridge University - for being in an intangible instrument as:

- In 2009, The first green bond listed on the London Stock Exchange by the World Bank”.
- In 2012, The Green Investment Bank was established, becoming the world's first such institution.
- In December 2015, 196 parties adopted the Paris Agreement to set a goal of limiting global warming to well below 2 degrees Celsius (°C) and to encourage financing for the investments required to support sustainable economic growth.
- In May 2018 as part of the EU's response to the Paris Climate Agreement, the EU's Sustainable Finance Action Plan was launched by the European Commission. A part of this Action plan is the Balkan deal...

The role of finance in climate change policies is emphasized in Article 2 of the Paris Agreement, which calls for “making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. (UNFCCC 2020).

In this uncertain environment, banks in Albania must act now on two fronts: they need both to manage their own financial exposures and to help finance a green agenda, which will be critical to mitigate the impact of global warming. An imperative in both cases is excellent climate-risk management.

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

CHALLENGES TO CREATING A WORKABLE MODEL ON CLIMATE-RELATED RISKS FOR BANKS

The assessment of effects from climate-related risks to the economy is a very complex exercise.

- Exposure to physical direct risks from climate-related (determined by the severity and frequency) affects all sources and capitals of the economy, including human and financial capital, as well as natural capital.
- Combinations of potential physical risks from climate threats come from all the sectors of the economy and to assess potential impacts of climate-related risks on the economy, variables including the entire spectrum of “inputs” and “outputs” need to be included for each sector.
- Moreover, their transmission channels to the economy should be viewed as direct and indirect ones. The range of variables increases as, besides direct risks, there are also transition risks which require costs and structural interventions in key sectors of the economy.
- A complex interaction of variables (micro and macroeconomic variables with social variables and natural ecosystem variables) renders difficult any modelling of the effects from climate-related risks to the economy.

In the meantime, **any delay by the banking sector for actions to tackle climate risks would have irreparable costs**

This study offer a Workable approach for banks:

- Recognizing immediately exposure to physical impacts of climate change, which could affect banks on both the assets and liabilities sides of their balance sheets.
- Understanding the transition risks and aligning the decarbonization agenda with bank's climate strategy. Redirecting funding away from activities that do not support the 1.5°C ambition.
- Finding the new opportunities that focus on green growth the transformation of brown assets into green ones.

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

WHAT DO WE KNOW ABOUT ALBANIA'S EXPOSURE TO CLIMATE-RELATED RISKS?

Albania is the most vulnerable country in Europe prone to various risks.

(Disaster-risk-finance-diagnostic-albania)

Event	Occurred (number of times the event has occurred)	Consequences (in affected individuals)
Droughts and fires	2	3,200,000
Earthquakes	6	8,429
Epidemics	2	292
Extreme temperatures	5	237,235
Floods	15	205,584
Landslides	1	26
Storms	2	525,000

Climate risk management is not just a process that will protect a bank from future loans losses, but is a proces that should start right now with identifying and measuring climate risks in the existing portfolio.

Protecting the balance sheet from uncertainty:

- The prolonged drought in Albania is related to the performance of such sectors as energy and agriculture.
- Higher temperatures would lower the output of typical agricultural products such as olives, tomatoes and grapes, both for domestic consumption and exports.
- In Albania, summer tourism is concentrated mainly along the coastal beaches. The level of the Adriatic Sea has risen on average around 15 cm during the past centuries. Seasonal changes in temperatures in Albania may see an extension of the summer season by 37 to 22 days from north to south. What would be the effect from structural changes in tourism on banks' portfolios?

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

MAPPING THE CLIMATE TRANSITION RISKS

The degree of structural and financial economic transformation of this transition is very significant, bringing at the same time risks and opportunities for the banking system and the real sectors of the economy.

These are the risks that are transmitted to financial risks for the bank and those come from:

- changes in climate policy towards a specific sector of the economy;
- legal obligations in implementation of the climate and energy treaties for the reduction of high emissions;
- technological changes necessary for a safe environment;
- as well as from structural changes of the market:

The below is supported by the study with latest data conducted by the McKinsey research on “A Mediterranean basin without a Mediterranean climate?” (include Albania). As the Mediterranean becomes warmer and drier, the risk of water supply shortage, the risk of massive fires and coastal floods increases.

The focus of transition risk management should be: - adaptation of energy as 30% of CO₂ emission; industry and sub sectors (production of cement, steel and chemicals); transport 19% of Co₂ and 75% road transport; agricultural sector for reduction of methane (CH₄ and NO₂).

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

Share of Co2 emissions, 2019, %						
CO2 emission	Power	Industry	Mobility	Buildings	Agriculture	Forestry
	30	30	19	6	1	14
Subsectors share of system emissions, %						
Co2 emission, 2019	Power	Industry	Mobility	Buildings	Agriculture	Forestry
	Electricity 97	Steel 26	Road 75	Residential 70	Farming 96	Fostery 100
	Heat 3	Cement 20	Aviation 13	Commercial 30	Fishing 4	
		Oil and gas extraction 15	Maritime 11			
			Rail 1			
		Chemicals 12				
		Coal 6				
		Other 20				
CH4 Methane emissionne %	Industry	Agriculture	Forestry	Waste		
	33	38	5	23		
N2O Nitrous oxide emmision %	Agriculture	Industry	Power	Forestry	Waste	Mobility
	79	8	3	5	3	2

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

ALBANIA DECARBONIZATION AGENDA

According to “National Renewable Energy Plan” a mandatory National Objective is set: 38% of energy consumption to be from renewable resources. For other sectors of the economy, the decarbonization agenda of the Albanian economy is already part of the integration processes

Deal for the Western Balkans”, a transition mechanism to help and finance the cost of the transition to a low carbon economy and addresses mainly 5 pillars: 1) decarbonisation, energy and transport 2) the establishment of a circular economy (closed cycle), 3) biodiversity, 4) combating air, water and soil pollution and 5) sustainable food systems and rural areas.

The EU’s objective for this investment plan is:

- It is planned to increase the amount of the grant to support the private sector... and 50% of the private sector funding from the EU should be dedicated to innovation and green growth.”
- “to cooperate with the financial institutions to support the countries of the Western Balkans in order to triple the current pace of renovation and energy saving,..”

Implementing this agenda requires a drastic transformation of our economy - starting with food production, energy production, transportation and infrastructure - and the replacement of old technology with low-emission technology alternatives and is understandable that the capital needs for this historic undertaking are enormous.

ALBANIAN BANKING IMPERATIVES FOR MANAGING CLIMATE RISK

ALIGNING BANK'S PORTFOLIOS WITH OF LOCAL AND REGIONAL CLIMATE AGENDA.

Several financial instruments have raised funds and aim at restructuring the high-emission sectors and regenerating natural ecosystems, besides the EU pre-accession instrument with a 9 billion euro investment plan, groups such as the Global Environment Facility (GEF), which raises funds for finance projects to protect biodiversity. The report of the independent group of experts of "Global Financial Stability Report No. 2020/001" has estimated that they are ready to be distributed as climate finance around \$100 billion". Constructing a climate-risk-management framework through reviewing two aspects: first, the business and credit strategy including capital allocations - the bank in its business plans should clearly announce the gradual lending restrictions for sectors with exposure to environmental risk as well as providing restructuring plans for those sectors that are in the process of transition.

The second, the loan approvals in the customer scanning process, environmental assessments at the macro level (industry sectors) and at the micro level (client and business segments) should be taken into account. The principles of corporate social responsibility and environmental sustainability (CSRES) adopted by many international financial institutions (IFC, WB, etc.), and the inclusion of climate transparency, are of triple importance for the banking system:

- first, it protects banks from reputational risk as well as protects their portfolios from climate risks;
- second, this alignment with the principles on climate responsibility turns banks and the entire banking system adequate to channel the global financing raised for climate; and
- third, it enables banks to recognize opportunities and innovations and co-finance profitable investments with an impact on the green and sustainable growth of the Albanian economy.