How Finance Ministries might think about Climate Change Adaptation…

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Three objectives:

1. Lay out what Finance Ministries might want to think about in terms of climate change adaptation
2. Present how the Coalition of Finance Ministers might help
3. Open a discussion on organization, deliverables, and next steps.

Familiar starting points:

- Climate mitigation is not on track, and climate change is now an inevitable and unprecedented economic, equity, and ecological challenge.

- To adapt, all countries need to:

  - Make climate risks visible, and use that knowledge as the basis for better planning and financing.

  - Recognize that good adaptation is good development, and vice versa. Adaptation is not a separate concern, but one to be mainstreamed at all levels.

  - Devote resources – sourced as diversely as possible.

SOURCE: GLOBAL COMMISSION ON ADAPTATION, SEPTEMBER, 2019

Building resilience: three complementary pillars:

1. Physical resilience (ex-ante)
2. Ex-post resilience (recovery and reconstruction)
3. Macroeconomic and financial resilience

SOURCE: IMF POLICY PAPER: BUILDING RESILIENCE IN DEVELOPING COUNTRIES VULNERABLE TO LARGE NATURAL DISASTERS, JUNE, 2019

Building resilience: three complementary pillars:

1. Physical resilience

- Resilient infrastructure
- Proper land use and zoning
- Building codes and related procurement standards
- Early warning systems
- Climate-resilient agriculture
- Nature-based solutions (NBS)

2. Ex-post resilience (recovery and reconstruction)

- Short-term contingency planning for post-disaster response, including public and social services, and safety nets with fast pay-outs
- Ex-ante financing arrangements for longer-term financing to "build back better"

SOURCE: IMF POLICY PAPER: BUILDING RESILIENCE IN DEVELOPING COUNTRIES VULNERABLE TO LARGE NATURAL DISASTERS, JUNE, 2019

Building resilience: three complementary pillars:

3. Macroeconomic and financial resilience

- Model short- and long-term economic and fiscal impacts of climate change as a basis for seeking solutions.
- Build risk into macro-fiscal and macro-financial frameworks – including going beyond physical climate risks to include (a) climate-related transitional and liability risks and (b) other, often more serious economic risks (foreign exchange, interest rates, liquidity, commodity prices, contractual).
- Assess budgetary explicit vs implicit contingent liabilities, impacts revenue streams (both domestic and trade-related), and on debt sustainability
- Explore range of public and private sector risk management instruments, such as:
  - Fiscal buffers/self-insurance
  - Contingency finance (e.g., catastrophe bonds, Cat-DDOs)
  - Risk-transfer instruments (of particular interest to V20 countries)
- Through financial sector regulation, strengthen the financial sector to disclose risk, manage risk, and expand into new risk-pooling markets (see next slide).

Adaptation-Related Interventions by Financial System Governance Bodies

Prudential

- Physical climate risk stress testing for regulated institutions; monitor NBFIs
- Climate risk screening and standards for public projects, procurement rules
- Integration of climate risk into disaster risk management funding, fiscal planning and contingency finance

Standard Setting

- Adopt coherent and consistent climate risk [guidelines/metrics]
- Require rating agencies to employ climate-risk ratings

Disclosure and Reporting

- Designate climate risk as a material risk
- Mandatory climate-related financial disclosures
- Disclosures presented in terms of financial value at risk, and opportunities to invest in resilience

Fiscal and Monetary Policy

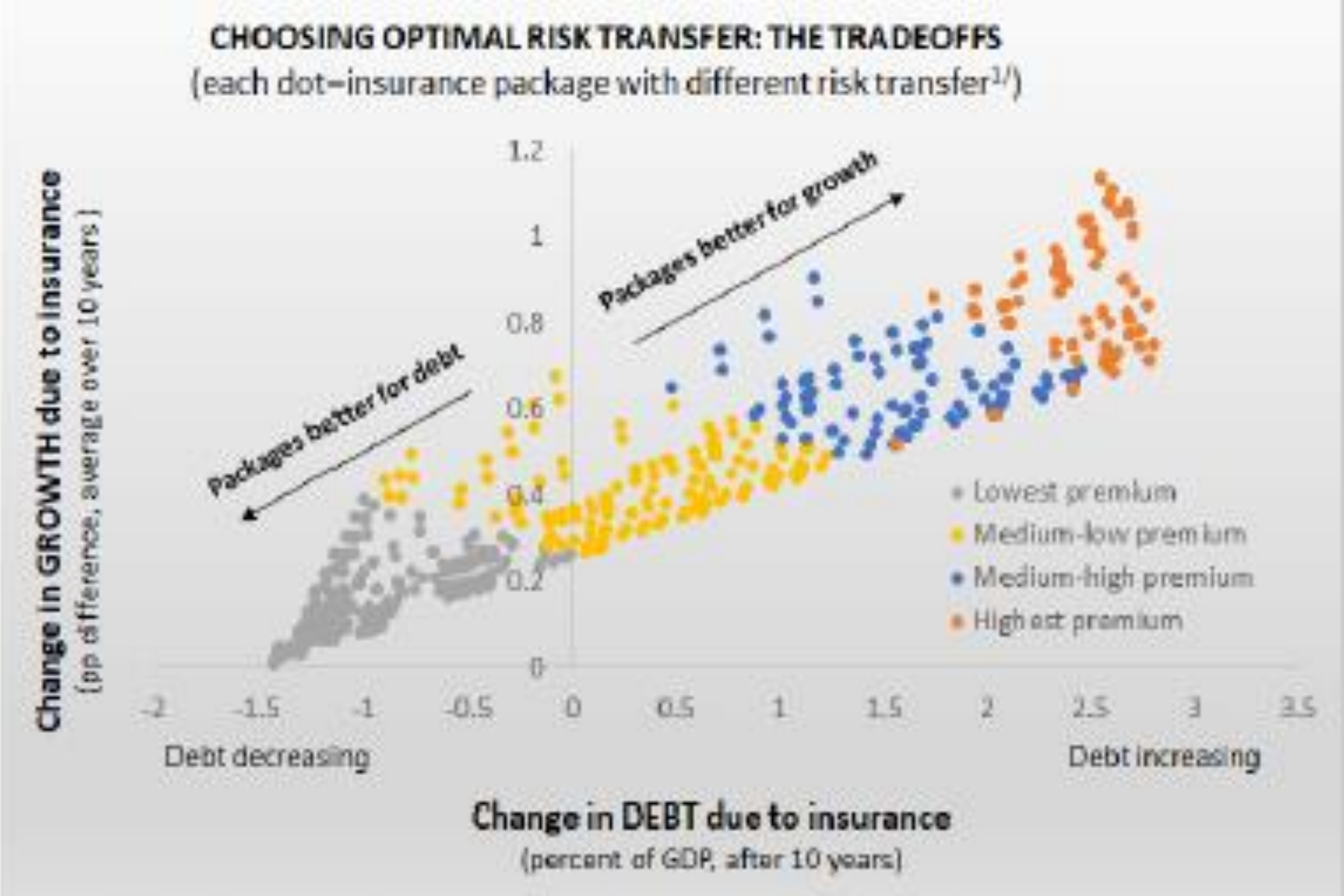
- Undertake economy-wide assessments of the impacts of physical climate risks
- Promote safety nets for vulnerable communities
- Develop long-term economic strategies that incentivize climate-resilience, remove regulations which incentivize mal-adaptation, and provide for contingency funds

Approaches for Managing Climate Change Risks

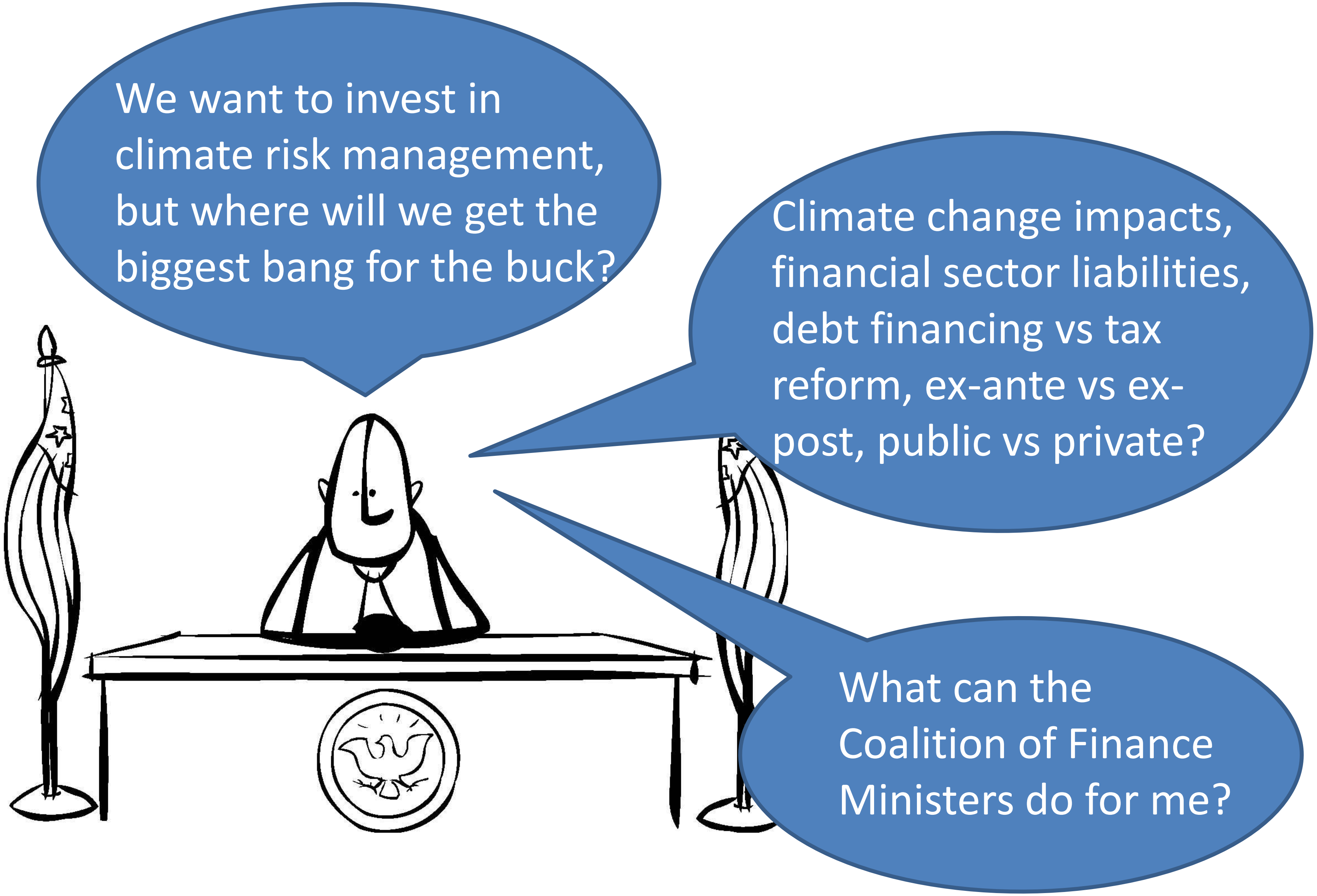
Risk reduction	Reduce vulnerability	• Diversify economy into climate-resilient production and livelihoods
		• Mainstream climate change into public investment management systems
	Reduce exposure to hazards	• Improve buildings codes, land-use planning, and zoning
		• Strengthen natural buffers (reefs, beaches, forests, etc.)
		• Improve ecosystem management
Risk financing	Risk retention	• Contingency and reserve funds
		• *Ex-ante* contingent credit
		• *Ex-post* borrowing
	Risk transfer and pooling	• Insure public assets
		• Multi-country sovereign disaster insurance
		• Catastrophe bonds
Residual risk management	Post-disaster response	• Livelihood support
		• Budget reallocation
		• Humanitarian relief

Sources: Adapted from World Bank 2014 and Mechler, Mochizuki, and Hochrainer-Stigler 2016.

A preliminary finding from the IMF – which is open for discussion: Should countries go into debt to increase climate insurance coverage?



1/ Each dot shows the average, for a given insurance package, of the difference in debt and growth outcomes between insurance and no insurance scenarios over 1,000 simulations.



We want to invest in climate risk management, but where will we get the biggest bang for the buck?
Climate change impacts, financial sector liabilities, debt financing vs tax reform, ex-ante vs ex-post, public vs private?
What can the Coalition of Finance Ministers do for me?

A Possible Approach of the Coalition of Finance Ministers towards: "Fiscal and Financial Aspects of Climate Change Adaptation" (1 of 2)

Organize a sub-working group (WG) on adaptation focused on the Fiscal and Financial Aspects of Climate Change Adaptation

- Co-led by AG and Finance Minister Khayoum of Fiji with ____ (tbd)
- Other countries member (and possible co-lead(s)) welcome
- Sub-working group to be supported by WRI/GCA, back-stopped by the World Bank and IMF
- Since this topic is cross-cutting, the sub-working group would work closely with, and feed directly into, the working groups for Pillars 4 (macroeconomics); 5 (finance) and 6 (NDCs). These linkages would be confirmed through both (a) joint learning activities and products, and (b) future Coalition commitments.
- Seed funding is currently available for the sub-working group, and to support all deliverables (see below), additional resources will be sought once the sub-working group is formally endorsed by the Coalition.

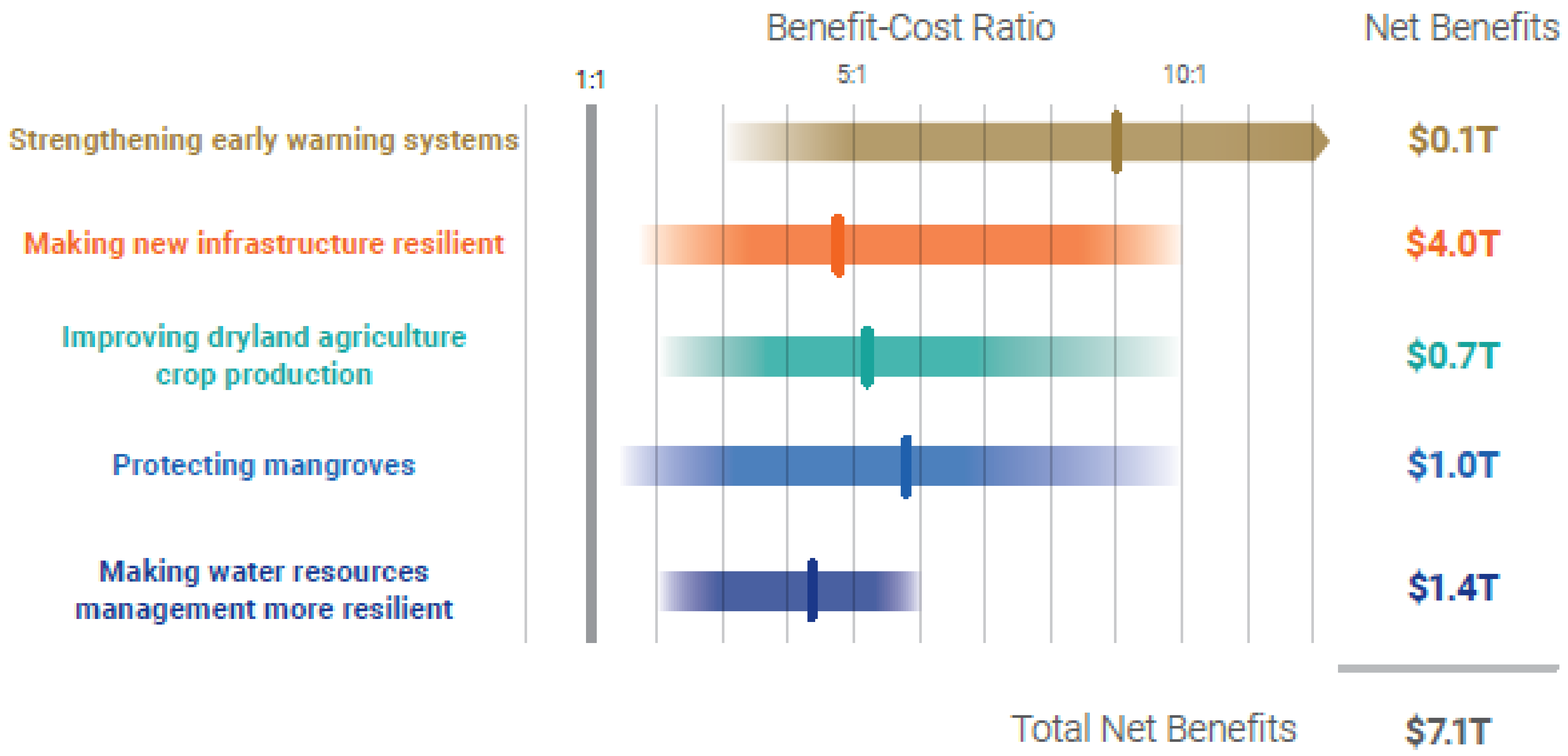
Possible Approach of the Coalition of Finance Ministers towards: “Fiscal and Financial Aspects of Climate Change Adaptation” (2 of 2)

Deliverables of the sub-working group could include:

1. 1 or 2-day learning session (similar to the one hosted by Sweden on carbon pricing) on the fiscal aspects of adaptation. To be planned for spring 2020, either on the side of the Spring Meetings, or shortly afterwards. Other in-country trainings will also be possible.
2. One or more protocols (guidance notes), toolkits, and a database on “pricing risk”, all informing how Ministries of Finance might fulfill their role on the three pillars of climate adaptation (i.e., physical resilience; ex-post resilience; and macroeconomic and financial resilience). Collaboration with the MDBs and IMF.
3. Deeper support to [4-6] pilot countries seeking to better understand, plan for, and finance climate risks – ideally from the macro to the network and project levels. Country selection will be based on demand.
4. Close alliance with the private sector Coalition for Climate Resilient Investment on financial innovation and metrics to help increase private financial flows into adaptation and resilience investments. Deep engagement will be based on country demand.
5. Country commitments to take concrete steps across the pillars, but particularly as concern elements for economic and financial resilience

Background slides

Climate Adaptation Delivers High Returns



Investing $1.8 trillion globally in five areas from 2020 to 2030 could generate $7.1 trillion in total net benefits.

SOURCE: GLOBAL COMMISSION ON ADAPTATION, SEPTEMBER, 2019

Multiple Benefits

INVESTING IN ADAPTATION YIELDS

AVOIDED LOSSES

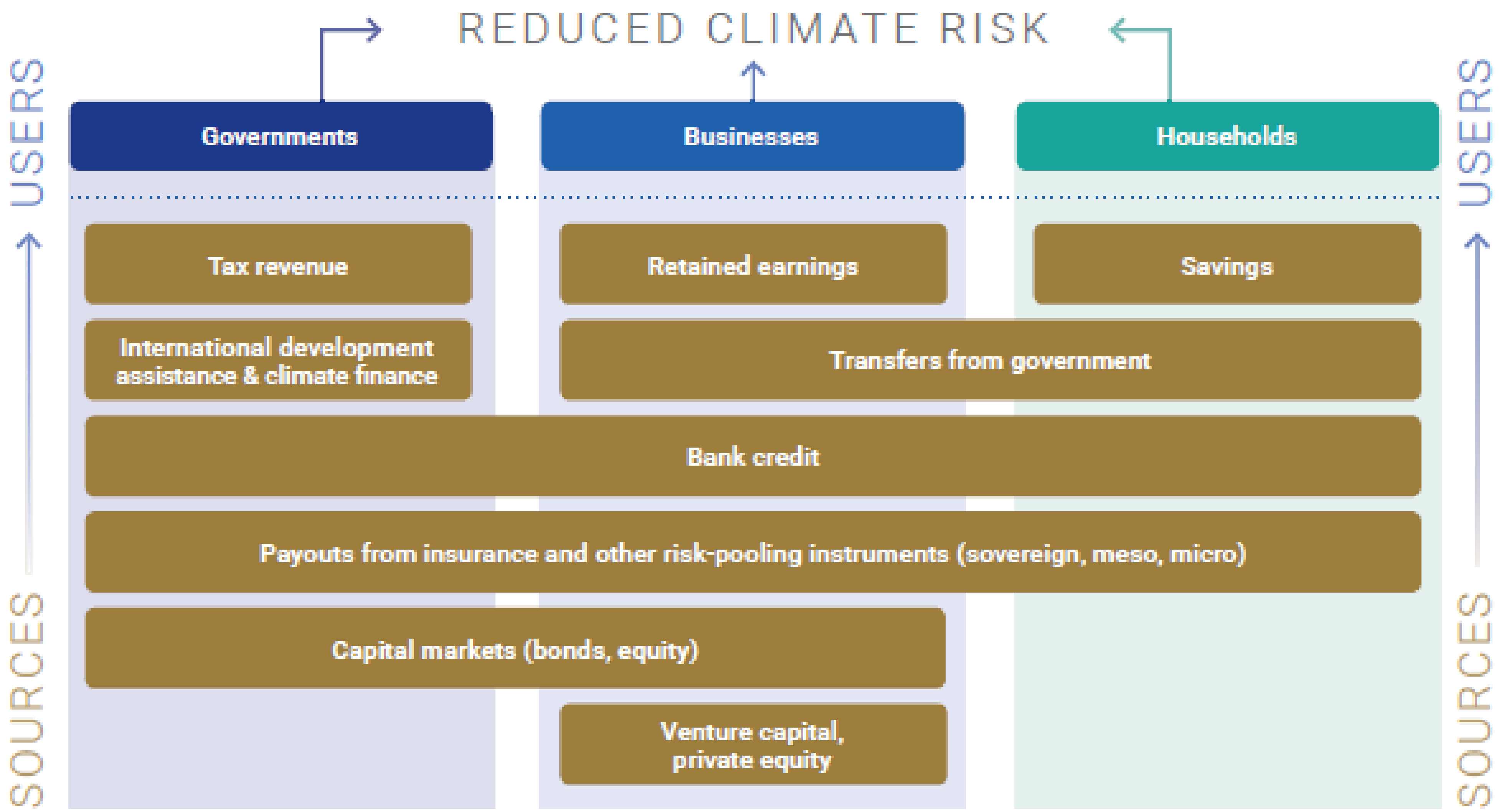
+ ECONOMIC BENEFITS

+ SOCIAL & ENVIRONMENTAL BENEFITS

= **A TRIPLE DIVIDEND**

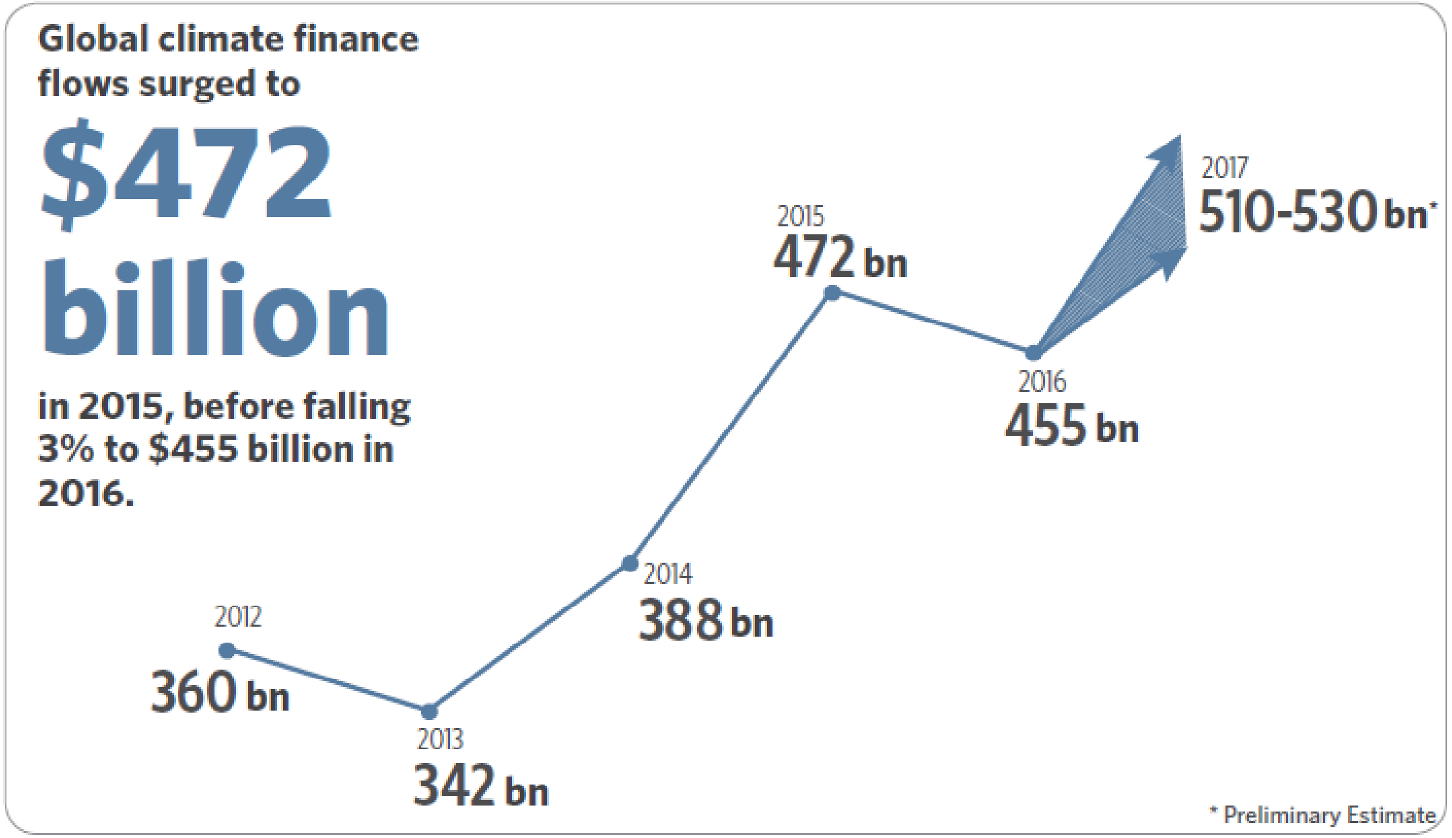
SOURCE: GLOBAL COMMISSION ON ADAPTATION, SEPTEMBER, 2019

Key sources and users of adaptation finance



SOURCE: GLOBAL COMMISSION ON ADAPTATION, SEPTEMBER, 2019

Where do adaptation resources come from?



- The public sector accounts less than half of the total; the private sector for more than half
- Only 5-7% goes to adaptation overall, mainly from the public sector
- Over 2015-16, 79% of climate finance was raised in the same country in which it was spent…. which confirms the importance of strong national policy and regulatory frameworks

SOURCE: CLIMATE POLICY INITIATIVE (CPI)

Draft: Objectives of the adaptation learning session being proposed for the spring of 2020

A. Support systemic approaches to the fiscal and financial management of climate risks

Engage national governments [and central banks] in fiscal risk management, contingency finance, climate risk screening of public investment programs, and procurement standards.

Deepen private and financial sector disclosure of climate related risks.

Develop a resilience rating system of expected resilience returns on investment (such as the World Bank's proposed resilience rating system).

Engage Rating agencies to systematically incorporate risk in investment ratings.

Engage insurance companies to develop improved products to incentivise up-front resiliency investments in both public and private sector assets.

B. Mobilising financing

Enhance investment pipelines and bankability of proposed projects.

Develop new financial models and instruments, including such innovations as resilience bonds, and expanded use of catastrophe bonds and contingency finance.

Mobilizing partnerships that serve the investment community, such as in technical best practice, design standards, procurement approaches, and shared modeling of climate scenarios.

Mobilizing MDBs, bilateral donors, and private philanthropies to increase adaptation finance commitments.

Support fund aggregation models and public-private financing models that facilitate scale and pooling/ diversifying risks.

Address challenges limiting access to adaptation funding at the local level by addressing barriers on funding models, transparency, monitoring progress, improving capacity of local institutions.