Blog

International recommendations help in identifying investment risks and opportunities related to climate change

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The goal of the Bank of Finland's climate work is to spread knowledge and debate around sustainable finance and to enhance expertise in this area.

Climate change will significantly affect the environment and the economy in the coming decades. On account of climate change, companies will have to change and adapt their business models. The change in the economy and markets will also be reflected in financial system stability, and in that way the issue is closely related to the work of central banks. The goal of the Bank of Finland's climate work is to spread knowledge and debate around sustainable finance and to enhance expertise in this area.

The TCFD **(Task force for Climate-related Financial Disclosure)** is an international reporting framework concentrated on the risks and opportunities of climate change. TCFD recommendations help companies as well as investors and financers to report their climate risks using jointly approved definitions.

The Bank of Finland published its 'Responsible Investment Principles' in January 2021. Reporting on investment activities does not yet embrace all the elements covered by the TCFD, but in the currently ongoing development project for climate work we have taken into account some of the missing elements.

The TCFD framework is divided into four components: Governance, Strategy, Risk Management, and Metrics and Targets. For each of the four components there are recommendations and supplemental guidance in the reporting guidelines to which organisations committed to reporting

should seek to respond.

Chart 1.

TCFD recommendations overview



Source: TCFD.

Due to the nature of central bank activities, we have also gone through supplemental guidance for several organisational groups.[1] In this way we have sought to ensure the recommendations will be examined in the Bank of Finland from as broad a perspective as possible. Some of the additional recommendations are more applicable to commercial banks than to central banking activities. On the other hand, it can be useful to reflect on one's activities by also acquainting oneself with the supplemental guidance aimed, for example, at actors outside the financial sector, in order to get an adequate picture of the effects, risks and opportunities of one's own activities.

Governance – intra-organisational governance of climate-related risks and opportunities

The Bank of Finland Board approves annually the responsible investment principles. New climate goals are planned to be ready during the course of 2021. These will be incorporated into the responsible investment principles, and the Board will monitor their implementation regularly, at least once a year.

At the Bank of Finland we have a working group on responsible investment, whose job is to oversee, monitor and report on the implementation of responsible investment. The working group meets at least every quarter.

The climate risks and opportunities of individual investments and external asset managers are monitored in the Bank's Asset Management division. The portfolio managers are supported in this work by a responsible investment specialist.

Strategy – reporting of potential and actual climate impacts from the perspective of business activities, strategy and economic planning

Based on our calculations and scenario analyses, we have identified where the most significant climate impacts arise in our investment portfolio. Our equity investments are in funds administered by external asset managers; hence the primary means of engagement are conversations conducted with the asset managers and monitoring their activities. For example, we monitor how the asset managers use their ownership rights and participate in discussions around the topic, including consultations on legislation. In real estate investments we devote attention to the environmental certification of real estate and the results and activities of real estate funds in the international GRESB[2] comparison.

For direct investments we are planning the introduction during the course of next year of an external climate data service, to enable us to more systematically identify the risks and opportunities relating to climate change. Due to the structure of our portfolio it has been a challenge to acquire comprehensive information. Various service providers have recently developed their calculation methods also in respect of government bonds and government issuers. In addition, we are continuing our thematic investments in sustainable-development-compliant and/or green bonds , taking into account the market situation.

Risk management – how we identify, assess and manage climate-related risks

We regularly ask our external asset managers about their TCFD reporting and monitor, for example, the identification, monitoring and management of climate-related risks.

A great deal of appropriately adapted information is required to identify climate-related risks and opportunities. In addition to our own data procurement, we have begun the process of procuring a special climate data service, which we aim to complete during the course of 2021.

External data makes easier and more precise the work of identifying our own portfolio's most significant impacts. In addition to identifying, assessing and managing risks, the aim is to report the portfolio's impacts to the different levels of the organisation, including the Board, as part of the regular reporting of the impacts of our investment activities.

Metrics and Targets

In order to set targets, we must know the current situation. The Bank of Finland has carried out the first carbon footprint calculations and scenario analyses in respect of our investment activities. In this way we have identified our portfolio's most significant sources of greenhouse gas emissions, using for the calculation weighted average carbon intensities. In building the scenarios we have drawn on the PACTA model.[3] The intention for the future is to use more sources in the calculation and in our scenario work, in order to further enhance our own knowledge as well as the reliability and coverage of the calculations. Responsible investment is an ongoing process of development, in which central banks should without preconceptions assess the climate risks of their own portfolios.

Keywords

climate change, climate-related risks, investment, responsible investment, responsible investment principles, risk management, sustainable finance