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Climate Change in Nigeria

Building Climate Resilience in the Nigerian Financial Services Industry

May 2023

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Content

Counting the Cost of Climate Change

With the rise in global temperatures currently threatening biological life and economies, the burden to avoid the worst effects of climate change extends beyond governments and Oil and Gas companies and anchors considerably on financial institutions.

The global climate change crisis is the defining crisis of our time, and it is happening more quickly than was ever anticipated. Every year, millions of lives are disrupted by increasingly frequent and severe climate change disasters including heatwaves, hurricanes, floods, and forest fires.

According to the UN's latest assessment, a lot of the damages caused by global warming to the natural environment are now considered "irreversible" [1]. However, to reverse or avert the economic loss and infrastructure damages caused by extreme weather events, there must be a call for civic, environmental, and financial responsibility.

Damages caused by extreme weather events linked to climate change result in phenomenal social and financial costs. For example, the losses from the severe flooding in Pakistan in 2022 are estimated to cost up to US$40 billion, negatively impacting 33 million lives. Pakistan's Ministry of Foreign affairs reported the loss of 1,600 lives, the destruction of over 2 million houses, damages to 13,000km of roads, and 18,000 km2 of cropland with up to US$2.3 billion in crop losses.[2]

Amidst climate change mitigation efforts, the London School of Economics suggests that developing countries may still face losses and damages costing between USD290 and 580 billion in 2030 and USD1–1.8 trillion in 2050. In Nigeria, extreme flooding submerged areas in 30 of the country's 36 states, affecting 7 million people and leading to over 400 deaths. According to Nigeria's National Emergency Management Agency (NEMA), the destruction and damage to about 597,476 houses left 1.3 million Nigerians displaced with an estimated USD17 billion in damages. [3]

Climate Change and the Threat to the Nigerian Financial System

Unlike developed countries with more diversified and technology-intensive economies, Nigeria's economy is largely dependent on its natural resources. Coupled with poor climate adaptation capacity and a lack of early warning systems, the country's economy is more vulnerable to the negative impacts of an unfolding climate emergency. In 2021, Notre Dame Global Adaptation Initiative (ND-GAIN) ranked Nigeria's vulnerability to climate disasters and its adaptive capacities at the bottom 15%, placing Nigeria at rank 161 out of 182 countries. The physical and transition risks brought forward by climate change are areas of increasing concern for the financial services sector[4].

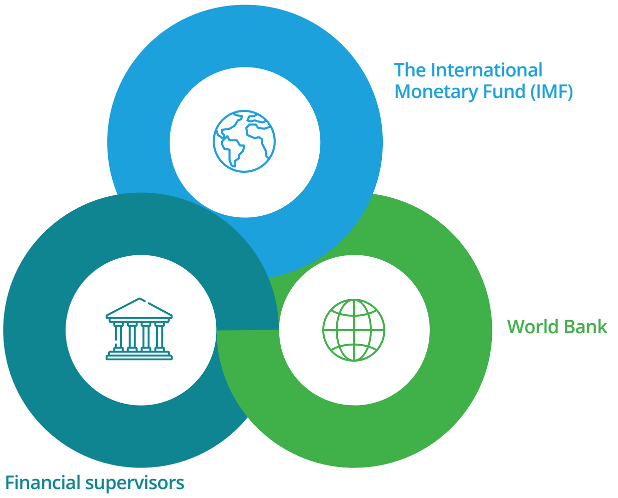
Physical risks such as damage to property, infrastructure, and land which expose businesses, households, and communities in disaster-prone areas to loss can cause a rippling effect on the financial system and the wider economy. This will be demonstrated by increased default risk of loan portfolios, lower values of assets, and increased frequency and severity in insurance claims. Insurers and reinsurers may even have to increase their coverage policies to include the likelihood of previously uncorrelated events, resulting in the unaffordability of insurance premiums in at-risk areas of the country.

On the other hand, Transition risks expose financial services institutions to incur losses that result from business models, loan portfolios, and financial policies which are not focused on the economics of decarbonization and sustainability.

Financial institutions in Nigeria must play a key role in tackling the climate emergency. Despite commitments to net zero by 2050, trillions of dollars in financing continue to sustain the coal, oil, and gas industries[5] which are at the core of the crisis, sustaining and expanding carbon emissions and the associated consequences. No climate commitment is complete without a plan to limit carbon-enabling financing and commit to financing a just transition to a zero-carbon society.

How Global Financial Institutions are tackling Climate Change

As financial systems around the world brace for the worsening effects of climate change, a key first step is to gauge the range of shocks that different economies may soon experience. Global financial institutions are performing stress tests [8]: an analytical process that quantifies the impact of possible systemic shocks that could surge through their financial systems. This process is notably adopted by the IMF, World Bank, and financial supervisors to aid comprehensive scenario planning geared towards preventing potential financial crises.



Climate Risk Analysis is also used to inform financial institutions about the potential magnitude of climate-related risks in business areas and help determine the extent to which the impact of climate risk is appropriately considered in the management of credit, market, operational, and other traditional risks.

Climate stress tests are employed by The Australian Prudential Regulation Authority (APRA), Bank of Canada, and Bank of England, to evaluate their climate-risk exposures [8]. This provides an understanding of the challenges these risks pose to business models, and the implications for the provision of financial services and helps institutions to work towards favourable policy responses. As countries begin to modify these measures to suit financial situations, climate risk analysis will be an asset to financial stability monitoring and supervision, enabling financial institutions to improve their disclosure and management of climate-related financial risks.

BankTrack's Banks & Climate campaign [5] challenges commercial banks to act urgently and decisively to help limit global warming to 1.5°C by ending finance for the fossil fuel industry and phasing out all financed emissions to net zero by 2050. The campaign is focused on eradicating bank financing for projects and companies with significant adverse climate impacts, supporting the global climate finance movement with research, tools, and collaboration; engaging with banks and industry initiatives to raise project-financing standards, either in banks' policies or as part of financial sector initiatives.

Globally, financial institutions and regulators are increasingly acknowledging the financial stability implications of climate change and are stepping up to the critical role of championing the climate transition. Without similar response measures and concerted efforts to build climate resilience, Nigeria's financial system risks the staggering economic consequences of climate change.

The Way Forward for Nigerian Financial Institutions

There are prominent challenges facing the adaptation of activities needed for actions designed to mitigate the effects of climate change in Nigeria.

Insurance, investment, and asset management initiatives centred on climate change are hindered by the lack or shortage of requisite frameworks to guide and support planning, implementing, and administering climate change initiatives.

Likewise, compared to developed countries, civil agitation for climate change in Nigeria remains in a relatively nascent stage. In 2021, Nigeria passed the 2021 Climate Change Act, West Africa's first standalone comprehensive climate change legislation. The Act provides a national-level framework for aligning climate actions with national development priorities, setting an ambitious net-zero target for 2050-2060.[13]

Nonetheless, the Financial Services Industry is still obligated to preserve its going concern in the face of the inevitable transition through a two-fold responsibility. The responsibility to its shareholders compels these institutions to prepare for the negative effects that climate change may have on their business and their customers. Similarly, social responsibility demands that financial institutions provide significant assistance toward mitigating economic risks related to climate change and lead Nigeria's transition to a low-carbon economy by providing appropriate climate transition funds and products.

Nigerian financial institutions can modify the frameworks for refinancing operations to incorporate climate risk analytics, possibly applying stringent scrutiny to assets materially exposed to physical or transition risks. This will further incorporate sustainability considerations into investment decisions for portfolios under management. By enforcing the inclusion of climate risks in financial statements, investors are provided with accurate and adequately standardized reports on the risk exposures of the companies to climate-related financial risks.

A good way to incentivize emissions reduction and mobilize revenues and alternative investment is through carbon taxing and other fiscal policies [10]. Financial regulators can put a price on carbon using carbon taxes, forcing emitters to face the environmental cost of their actions, thereby managing carbon output. In response to such policies, financial institutions can play a complementary role to accelerate the achievement of Nigeria's carbon reduction goals. Since carbon tax will make carbon emissions more expensive, financial institutions can mobilize resources needed for investments in climate mitigation projects from investors seeking to maximize investment returns or diversify their portfolios using alternative investments. To increase public adoption of carbon taxes, regulators can phase in carbon taxes over time, redistribute carbon tax to ease the impact of the tax on low-income households, and earmark carbon tax revenues to finance additional climate change mitigation [10].

Additionally, closing data gaps is crucial in tackling the economic impact of climate change. Financial institutions in Nigeria can act as data repositories for climate investment data and provide information on Climate-Related Projects. The African Development Bank has launched the Africa Climate Change Data Monitor service, which provides comprehensive coverage of climate change datasets on Africa. This is widely used across all African countries and contributes to the World Bank climate data repository [9].

On the other hand, several opportunities for the Financial Services Industry could contribute to increases in valuations, if climate change initiatives and strategies are properly implemented. Climate change not only creates new risks, costs, and liabilities for financial institutions, but it also generates economic opportunities such as investments in renewable energy technologies, energy efficiency projects, emissions trading, weather markets, and climate change-related microfinance.

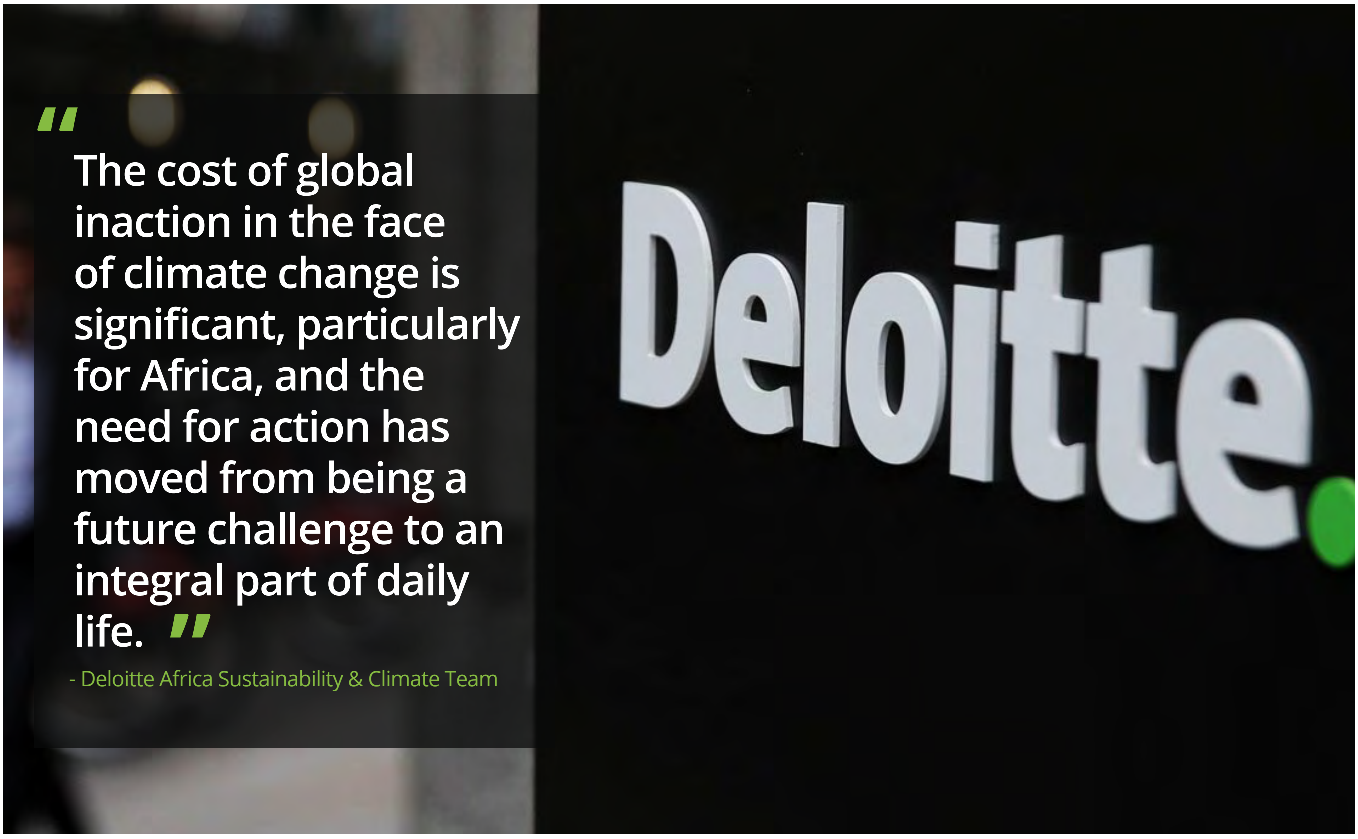
Emissions Trading:

With the implementation of the Kyoto Protocol in February 2005 and the launch of the EU ETS in January 2005, a worldwide emissions trading market with a variety of opportunities for financial institutions was established[14]. This market-based strategy for lowering greenhouse gas emissions encourages the development of cleaner technologies and offers financial incentives for businesses to cut their emissions. Financial institutions, such as banks, investment businesses, and insurance companies, are eligible to take part in emissions trading and benefit from several opportunities, including offering to fund initiatives that reduce emissions and trading carbon credits [11].

Structured Finance:

There are several structured finance opportunities for financial institutions looking to adapt their strategies to address climate change [11]. Examples include; green bonds, climate risk insurance, green mortgages, and sustainable infrastructure investments. By incorporating these opportunities, financial institutions can not only help address the challenges of climate change but also position themselves for long-term success in a world that is increasingly focused on sustainability [11].

How Deloitte Can Help



With the development of climate risk, the risk management challenges faced by the Financial Services industry in Nigeria are becoming more complex to identify and manage, coupled with the extra pressure of managing internal resource constraints.

Globally, financial services regulators are moving to ensure banks identify risk exposures from climate change, establish strategies and adjust business models to manage them. The adoption of climate awareness in financial regulation in Nigeria will result in an expectation of key players to provide an effective oversight aimed at the proper identification.

Deloitte is a global consulting firm that offers a range of services to assist financial institutions in addressing climate change. Here are some of the offerings that Deloitte provides:

1. **Climate risk management:** Deloitte helps financial institutions identify and assess climate-related risks, such as physical risks (e.g. extreme weather events) and transition risks (e.g. changes in policy and market trends). Deloitte also assists in developing strategies to manage and mitigate these risks.

2. **Scenario analysis:** Deloitte can help financial institutions develop and implement scenario analysis tools to assess the potential impact of climate change on their business operations and financial performance.

3. **Sustainable finance:** Deloitte provides advisory services to help financial institutions develop sustainable finance products and strategies, such as green bonds, green loans, and other climate-related investment products.

4. **Reporting and disclosure:** Deloitte helps financial institutions report on their climate-related risks and opportunities, in line with international reporting frameworks such as the Task Force on Climate-related Financial Disclosures (TCFD).

5. **Assurance and verification:** Deloitte provides assurance and verification services to assess the accuracy and completeness of financial institutions' climate-related disclosures and reports.

6. **Regulatory compliance:** Deloitte assists financial institutions in complying with emerging climate-related regulations, such as the European Union's Sustainable Finance Disclosure Regulation (SFDR). frameworks such as the Task Force on Climate-related Financial Disclosures (TCFD).

The future of financial services is green and being ahead of this transition is an opportunity to create a considerable competitive advantage. To address climate change, financial institutions must establish strategies and structures that accommodate and reconcile both the risks and opportunities arising from climate change and the transition to a greener economy.[12]

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