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EVALUATING CREDIT RISK IN THE FACE OF CLIMATE CHALLENGES

MARKET ANALYSIS THOUGHT

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Nowadays, business is conducted globally: every day, buyers on one continent purchase goods and services from suppliers on another. Credit insurers facilitate these exchanges and protect companies' cash flows by providing insurance coverage against client default. One of the key elements of effectively managing credit insurers' risk is their capacity to anticipate difficulties (risk prevention).

Global Business Dynamics: Navigating Risk Amidst COVID-19 and Climate Challenges

Recent events like the COVID pandemic, armed conflicts, and inevitable climate-related catastrophes have shown that extreme risks may become more frequent. Climate-related. Human activity and consumption over the years have led to significant global warming events due to the release of greenhouse gases from burning fossil fuels for energy. As the Earth's temperature has risen, there have been more extreme weather conditions in the twenty-first century. These include heat waves, tornadoes, extremely cold winters, flooding, and drought affecting many parts of the world, such as North America, Europe, Asia, and Australia.

When it comes to climate change, there are two main types of risk:

- Physical risk is the physical impact of climate change, including natural disasters and extreme weather events. This can affect supply chains and damage assets, leading to customer default and more claims.
- Transition risk is the financial cost companies and sectors incur as they transition to a low-carbon economy. This typically includes lower demand for products no longer considered acceptable and the cost of compliance with government legislation.

Besides the direct impact on quality of life, climate change has caused monetary and financial losses to insurers and companies alike, sometimes inadvertently affecting the latter's creditworthiness, as extreme events affect or destroy assets or the ability to operate. According to a 2021 report by Impax Asset Management Group, as many as two-thirds of large companies globally possess at least one asset that will be impacted by the physical risk of climate change (defined above). Yet, in today's context, there are few concrete ways to accurately and meaningfully capture physical risks in the credit risk underwriting process that could result in financial losses or affect a company's creditworthiness.

> *Two-thirds of large companies globally possess at least one asset that will be impacted by the physical risk of climate change.*
>
> Impax Asset Management Group

How can we measure and manage climate-related risk?

We can begin by briefly examining the ESG approach, a relatively new concept whose Environmental factor (the "E" in ESG) attempts to measure a debtor's contribution to climate change and commitment to alleviating their carbon footprint via company policies and undertakings. Assigning various parameters, metrics, and weights results in a score that helps lenders gauge the debtor's resilience to ESG risks in the longer term. However, does this approach reveal anything about a debtor's creditworthiness (i.e., their ability to repay and hence the probability of default), or does it only measure social and environmental responsibility in the conduct of business?

We could also consider the Task Force on Climate-related Financial Disclosures (TCFD) set up by the Financial Stability Board (FSB) based in Basel. The task force helps lenders, insurance underwriters, and investors evaluate a company's exposure to climate risks via a reporting framework that discloses the company's climate-related risks and assesses the impact of those risks and how they can be managed. The framework began as an optional set of considerations in 2015, but today, it is mandatory in many regions, including Canada, the EU, South Africa, Singapore, and Japan. More countries are joining the pack, with Switzerland, New Zealand, and the United Kingdom enacting measures in 2021, 2023, and 2025, respectively.

While the global community of lenders and risk underwriters have identified climate change's real and potential impacts on credit risk, many are still trying to find the best approach to most accurately identify and assess such risks as part of the decision-making process. Until a global consensus can be reached, we will likely continue discussing and debating the best approach for some time to come.

As we delve deeper into the complexities of international business resilience, an insightful journey awaits in India's groundbreaking ESG initiatives. Join us in unraveling the transformative strides towards sustainability and discover the dynamic landscape of India's environmental, social, and governance endeavor.

> *The Task Force on Climate-related Financial Disclosures' reporting framework, disclosing companys' climate-related risks and assessing the impact of those risks and how they can be managed is today mandatory in many regions.*

About the Authors

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Weiling joined Tinubu Singapore in 2015 as a Risk Underwriter and has led the credit risk team in APAC since 2018. She is well-versed in the types of credit information available on the market. She is experienced in underwriting credit risks for micro-enterprises, SMEs, large enterprises, and MNCs across the APAC region. She previously served as a manager of the Enterprise Finance department of SPRING Singapore, an economic agency whose mission is to help develop Singapore enterprises. Weiling holds a BBA(H) from the NUS Business School.

Martin SHEPPARD

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Martin joined Tinubu in 2010 as Risk Director. Today, he leads the Tinubu credit risk teams, including underwriters from France, India, and Singapore. Martin combines strong analytical skills and a broad knowledge of international risk management. Before joining Tinubu, Martin spent 18 years at Allianz Trade (Euler Hermes), where he held various positions as Head of Risk Underwriting in the UK, Italy, and France.

Martin holds a BA (Hons) degree from London Metropolitan University.

About Tinubu

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Our company is an alliance of technology software and insurance expertise offering the best combination to its clients. It covers the entire value chain of credit insurance & surety with one end-to-end platform, connecting every part of your business with one digital highway.

Established in 2000 and headquartered in Paris, France, Tinubu is an independent software provider and employs 170 people, located in Paris, London, New York, Orlando, Singapore, and Montreal. Its clients represent 30 of the top 60 Credit & Surety underwriters worldwide.