How Emerging Market Banks Can Finance Adaptation and Resilience

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Banks in emerging markets have a unique and significant opportunity to create real value by providing their clients and communities with the adaptation and resilience (A&R) financing they need to prepare for and adjust to climate-related risks.

Disasters related to extreme weather already represent real financial losses for banks that operate in emerging economies, since floods, fires and storms hit vulnerable clients harder and more frequently. The costs to farmers, homeowners, infrastructure providers, and other at-risk clients are showing up on banks' books in the form of diminished collateral value, client loan defaults, and the impact of reduced insurance coverage.

Without active management, banks in emerging markets will see these costs and portfolio risks increase significantly. Yet they have been slow to understand both the risks and the opportunities these hazards present to protecting and creating value. Early adopters that establish themselves as the go-to provider of A&R financing in their markets can lock in significant first-mover advantage.

For many of these banks, the cost of funding has been a major impediment to assessing weather-related risks and developing an A&R finance platform in response. Fortunately, concessional capital is available for these kinds of investments from international climate funds, and there are clear market precedents for commercial banks keen to develop A&R financing products for their clients.

This article analyzes the current state of A&R financing in emerging markets and provides guidance on how these banks can take the steps needed to capture this opportunity.

How Banks Can Win

Commercial banks in emerging markets don't typically come to mind as vulnerable stakeholders in the mounting focus on adaptation and resilience. While they may not be directly affected by the damage inflicted by weather-related disasters, the financial implications for banks are irrefutable and climbing.

Fortunately, commercial banks can take tangible steps to identify risks and opportunities and manage them for a potentially significant competitive advantage. Banks should begin by building internal capabilities to assess and price physical weather-related risks. Then they can create value by developing financial products to support the needs of their clients, while mitigating risks by engaging with clients, adjusting financing terms, and rebalancing their portfolios.

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As the local conduit for access to A&R finance, commercial banks can position themselves as the financier of choice for two types of clients. They can support innovative, high-growth clients that are providing a range of adaptation and resilience products and services, which are set to grow at impressive rates as demand climbs. And they can engage with vulnerable, high-risk clients to encourage risk assessment and planning while creating financial products that facilitate these clients' investment in climate-related interventions.

Unlike decarbonization initiatives that often depend heavily on enabling governmental policies, demand for A&R solutions is essentially apolitical. That's because such financing covers basic needs like access to food, water, housing, and medical services. Agriculture, water and sanitation, and infrastructure top the current value of solutions needed to prepare for the potential impact of weather-related hazards (see Exhibit 1).

EXHIBIT 1

Demand for A&R Financing Is Coming from a Variety of Sectors

Category	Key Segments	Market Size 2024 ($billions)	% Anticipated Growth 2025–30 (CAGR)
Climate intelligence and risk analytics	Forecasting, asset scoring, analytics	4–6	up to 30
Flood defense and drainage	Modular barriers, basins, engineering	30+	up to 15
Climate-adapted agricultural inputs	Seeds, abiotic stress protection, biofertilizers	seeds 50–60; abiotic inputs 2–3	up to 13
Urban and industrial water efficiency	Smart meters, leak detection, trenchless pipes	metering 4–5; leak detection 2–3	up to 12
Emergency medical services	Portable devices, ambulances, mobile hospitals	20–25	10–12
Active cooling	Efficient AC units, industrial cooling, cold storage for food and medicines	30–35*	10–12
Distributed energy solutions	Microgrids, decentralized renewables, backup power for hospitals and critical infrastructure	20–25*	8–10
Resilient building materials	Storm and fire-resistant façades, insulation, green concrete	façades 40–45; structure 60–65	7–10
Passive cooling	Cool roofs, reflective paints, ventilated façades, natural ventilation design	15–20	7–9

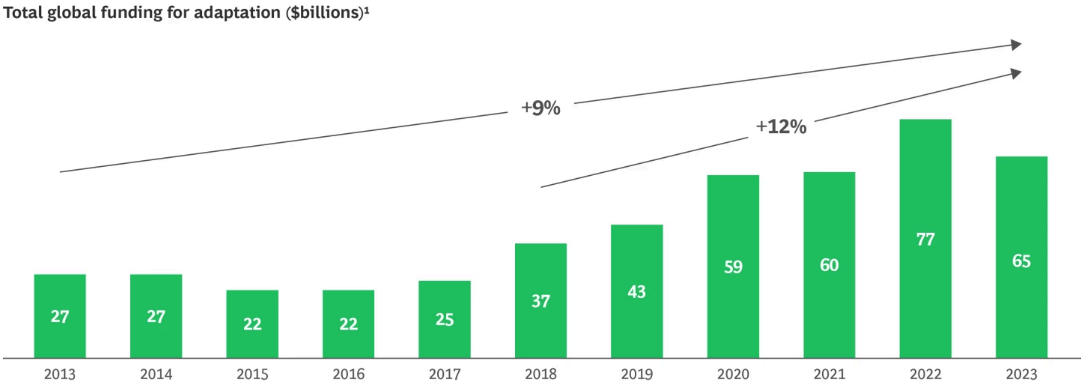
Sources: Temasek; BCG analysis.
Note: * = estimated.

Finding the Financing

Meeting this rising tide of demand for A&R products and services will require financing, which banks can provide with a range of instruments such as small-business loans, asset-based financing, corporate lending, and project finance. Currently, A&R-related financing represents just 10% of all climate finance. But it is growing fast—more than 12% annually between 2018 and 2023—as companies come to understand the need to adapt to changing weather conditions and increase resilience to their effects (see Exhibit 2).

EXHIBIT 2

Funding for Adaptation and Resilience Has Grown Rapidly in Recent Years



Sources: Climate Policy Initiative; BCG analysis.
[1]Includes public, private, and blended funding that supports climate resilience and risk reduction.

Yet A&R financing can sometimes be perceived as risky, fragmented, low-margin, or unbankable, especially when compared with climate financing for mitigation efforts such as renewable energy, electric vehicle fleets, or green buildings. Moreover, the cost of capital has been high, especially in emerging markets; high global interest rates, foreign exchange volatility, and risk premiums can make offering lower-interest-rate loans for climate investments a challenge.

What's at Risk

The Network for Greening the Financial System, a global coalition of central banks, has recently revised its assessment of the impact of physical climate risks on the global economy: what was an expected 5.4% loss of global GDP has now risen to a predicted 14.8% loss by 2050 under current climate policies.

> "Just 8% of banks in Asia and Oceania and 13% of companies in Africa have evaluated the resilience of their business strategy against a range of climate scenarios.

Despite such projections, banks in emerging markets are not reporting on the physical climate-related risks they face. According to the Financial Stability Board's Task Force on Climate-Related Financial Disclosures, just 8% of banks in Asia and Oceania and 13% of companies in Africa have evaluated the resilience of their business strategy against a range of climate scenarios.

The financial impact of climate disasters like storms, floods, fires, extreme heat, and rising sea levels is already hitting commercial bank loan books, primarily in the following three ways:

1. Decreased Insurance Coverage and Rising Premiums. Insurance is the first line of defense for physical climate risk. Even in the most developed markets, however, coverage averages only around 50%. This drops to between 0% to 10% in emerging markets such as Africa, Latin America, and Southeast Asia, leaving local governments, communities, and the banks that finance them to absorb the losses. (See Exhibit 3.) Making matters worse, insurance companies, in response to increased risk, are raising premiums past affordable levels for some clients or reducing coverage in the most vulnerable areas.

Emerging markets face an additional, compounding factor: insurance products exist for acute hazards like fires and floods, but the insurance market has struggled with appropriate products to cover losses from chronic hazards such as extreme heat. Extreme heat in particular is increasingly being recognized as a major driver of financial damages across sectors, and the frequency of such incidents tends to be higher in emerging markets.

2. Increased Risk of Default. Bank clients that suffer major or repeated losses are less able to meet their repayment obligations, dramatically increasing the risk of default. In low-income countries, the number of nonperforming loans increases by 5.8 percentage points within one year following a disaster, according to the World Bank. Potentially exacerbating the situation, credit rating agencies are beginning to factor physical climate risk into their ratings. Credit downgrades increase the cost of capital, potentially straining already unstable financing structures and further driving defaults.

3. Decreased Collateral Value. Bank clients with assets or businesses in highly exposed areas and limited options for insurance or resilience interventions are facing devaluation, lowering the value of banks' collateral and increasing their risks.

Seizing the A&R Opportunity

To identify the risks and opportunities in A&R financing and to manage them for a potentially significant competitive advantage, commercial banks in emerging markets should take tangible steps in three areas: building capabilities and assessing risk; creating value; and mitigating risk.

Begin Building Capabilities

To respond to the increasing risk of climate hazards and help provide the funding needed to mitigate it, commercial banks in emerging markets need to begin by getting their own houses in order. This means building the internal capacity, systems, and talent needed to better assess their clients' physical climate risks, support their A&R efforts, and create value in their own portfolios.

Importantly, banks need to assess their client loan books for portfolio exposure and vulnerability to climate hazards. To determine their risk, bank leaders should ask themselves five questions:

- What is my exposure to physical climate risks, and which sectors and geographies are most vulnerable now and in the future?
- What will be the financial impact of these climate risks, and which clients are most at risk?
- Based on our bank's priorities, which sectors, clients, and A&R-related products should we promote and encourage, and which should we divest away from to increase our own resilience?
- Are there any particular clients and sectors that are especially at risk of defaulting, losing collateral, or losing insurance coverage that we should divest away from?
- What strategic, targeted financial products can we offer clients to build resilience across our portfolio?

Additionally, banks need to segment their clients into two groups:

- **High-growth clients** that develop and offer climate adaptation and resilience products and services, such as climate intelligence, drip irrigation systems, and energy-efficient heating and cooling systems.
- **High-risk clients** especially vulnerable to the impacts of climate hazards, including small farmers, fisheries, and commercial real estate firms.

Create Value Across the Portfolio

Once the capabilities and portfolio assessment is complete, banks should then apply the insights gathered to take advantage of opportunities in support of high-growth clients while helping more vulnerable clients mitigate their particular climate risks.

Identifying high-growth clients that provide A&R services and solutions will be a key strategy for securing first-mover advantage as the A&R financing partner of choice in a bank's local market. Demand for A&R solutions is already building and is expected to enjoy double-digit growth rates in the coming years. Such solutions include climate intelligence and risk analytics, cooling systems, storm-resistant glass, fire-resistant building materials, emergency medical services, potable water solutions, and others.

Banks should begin by engaging with high-growth clients to understand how they can help finance their expected growth, positioning themselves early as the "A&R-friendly bank" to establish first-mover advantage in their markets.

To that end, banks should offer a full range of products such as small-business loans, asset-based financing, corporate lending, and project finance. These offerings support clients' financing needs while encouraging them to invest in their own A&R risk mitigation measures. Banks could also make equity investments in these high-growth clients, offering high-risk capital for startups and growth-oriented small and midsize companies that are developing A&R products and services, such as climate monitoring, agricultural technology, and climate disaster insurance.

Banks' more vulnerable, high-risk clients may require a somewhat different approach, involving affordable, flexible financing such as resilience-linked microfinance and small-ticket loans with pricing and tenor incentives for boosting resilience. Other options include mortgages with lower interest rates or longer repayment tenors linked to resilience measures, such as greater water or energy efficiency and flood proofing. Banks should also consider providing these clients with A&R advisory products, including risk scoring, readiness assessments, intervention pricing, and deal due diligence.

Building such A&R finance platforms will likely require banks to access outside financing. One such source is concessional finance, which allows banks to offer their clients lower-cost financing. This includes grants, loans, guarantees, and equity investments. Banks can use grants to assess the physical climate risk of their portfolios and build internal monitoring and reporting systems. Loans can be used for on-lending client deals and guarantees for derisking the A&R loans they make available. Banks can use equity to invest in clean-tech funds and other green opportunities. Sources of concessional finance include international climate funds, multilateral development banks, and development finance institutions.

One such fund, the Green Climate Fund (GCF), has raised almost $30 billion in committed contributions for concessional financing since its establishment in 2010. Its mandate is to commit 50% of its funds to adaptation efforts and to prioritize private sector engagement. It offers a range financing of instruments, including grants, concessional loans, equity, and guarantees, in hopes of enabling blended structures that de-risk projects and further mobilize private capital.

It's important to note that while concessional finance can play a vital enabling role for banks, it does come with its own complexities. The application process and approval timelines are long and complex. There are intensive due diligence and reporting requirements, and navigating the politics can be challenging. Finally, these funds face growing resource constraints as their major donors deal with competing fiscal priorities.

Act Fast to Mitigate Risk

Given the significant financial implications of climate hazards in their portfolios, banks in emerging markets should take five key steps to reduce their risk even as they seek out opportunities to create value:

- **Regularly review portfolios.** Consistently rebalance high-risk portfolios through pricing reviews, selective divestment, and other measures.
- **Treat climate risks as core financial risks.** Embed physical risks into underwriting, collateral, and portfolio management, and strengthen disclosure to meet investor and regulatory expectations.
- **Build institutional readiness.** Use concessional readiness grants to develop data, systems, A&R staff, and governance mechanisms that will strengthen the ability to assess climate risk.
- **Develop market-leading client solutions.** Offer tailored financial products that differentiate between high-growth clients and high-risk clients.
- **Leverage concessional finance strategically.** Begin early to access concessional funding from GCF and other funds, and then blend concessional and commercial capital to de-risk investments and promote the inclusion of private finance.

To position themselves for long-term leadership, banks should act now to secure first-mover advantage in the A&R finance market while strengthening their reputation as trusted resiliences partner to clients, regulators, and investors.

Commercial banks in emerging markets can play a major role in helping their clients, and their wider communities, to adapt to and mitigate the impacts of climate change, while de-risking their own activities and creating value for themselves.

To succeed, banks need to develop capabilities in assessing portfolio risk and creating A&R financing products for both their high-growth and high-risk clients. Those that move quickly can capture a significant first-mover advantage in this rapidly growing market.

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