

Climate Risk Strategy

SPAREBANK 1 SMN
2021

Introduction

Purpose and delimitations

This document describes SpareBank 1 SMN's strategic approach to climate risk. It sets the stage for targeted, consistent climate risk management throughout the group and across business lines. The strategy will ensure that risk management policy and the sustainability strategy both play their part in the work on climate risk.

SpareBank 1 SMN employs the TCFD's¹ recommendations in its work on climate risk. However, the present document is not a report under the TCFD framework. A separate TCFD report will be prepared.

Description of climate risk

Continued global warming will lead to more extreme weather, rising sea levels and changing weather patterns. Climate profiles² for our market area show that in the future we can expect increasing heavy precipitation, rain flooding, all forms of landslide and storm surge if global warming continues. We may also experience longer periods of drought. These events may cause physical damage to assets and infrastructure, or reduce the attractiveness of properties due to the risk of physical damage. For agriculture, more extreme weather can lead to crop losses, resulting in financial loss for those affected. More extreme weather could impact the SMN group directly through damage to its own property or indirectly through our customers' exposure to physical injury.

In order to prevent catastrophic consequences of global warming in the long term, greenhouse gas emissions need to be reduced as soon as possible. The Paris Agreement of 2015 commits its 196 signatories, which include the EU and Norway, to reduce greenhouse gas emissions. The EU has established a common front to achieve the goals of the Paris Agreement through the European Green Deal. This plan aims to halve Europe's emissions by 2030 and to make Europe a climate-neutral continent by 2050. Its instruments include extensive regulatory changes for most sectors, including the financial industry. One of its goals is that private capital should be channelled to investments in sustainable activities. While these are necessary and positive measures, they could jeopardise existing activities. This will prompt structural changes in the Norwegian economy, for businesses and private individuals alike. The transition to a low-carbon society will create problems for firms that fail to adapt.

We define climate risk as the risk of the bank incurring financial loss or reputational loss that can either be related directly to climate change or that is a consequence of adapting to a low-carbon society. Climate risk is further divided into sub-categories based on the most important risk drivers, as shown in Figure 1.

¹ TCFD (<https://www.fsb-tcfid.org/recommendations>)

² Norwegian Centre for Climate Services (NCCS)

	Climate risk	Traditional risk
	Political and legal <ul style="list-style-type: none"> • Carbon pricing and requirements on reporting • Regulation of existing products and services • Liability for damages following lawsuits 	Credit risk <ul style="list-style-type: none"> • Defaults by firms or private individuals • Reduced value of collateral
Transitional risk	Technological developments <ul style="list-style-type: none"> • New products or services with low greenhouse gas emissions replace existing solutions • Failed investment in new technology Market <ul style="list-style-type: none"> • Change in customer behaviour • Uncertain market signals • Higher raw materials costs Reputation <ul style="list-style-type: none"> • Negative mention and references and stakeholder concerns • Stigmatisation of the sector 	Market risk <ul style="list-style-type: none"> • Falling share and bond prices
		Liquidity risk <ul style="list-style-type: none"> • Higher price of non-green financing • Refinancing risk • Increased liquidity requirements
		Strategic risk <ul style="list-style-type: none"> • Insurance losses from Fremtind • Reduced growth opportunities in our market area
Physical risk	Acute <ul style="list-style-type: none"> • Increasing extreme weather causing damage to assets Chronic <ul style="list-style-type: none"> • Changed climate permanently affecting the ability to utilise natural resources and land areas 	Operational risk <ul style="list-style-type: none"> • Physical damage to SMN's assets • Operational disruptions due to extreme weather events

Figure 1: From climate risk to traditional financial risk, including examples. Figure inspired by NGFS.net.

For SpareBank 1 SMN, all the above risk sub-categories will impact on the group's activities both directly and indirectly through our customers. A common groupwide standard has accordingly been drawn up to handle climate risk.

Responsibilities and organisation

Board of directors

Climate risk responsibilities follow the group's ordinary responsibility structure, in conformance with the risk management policy. In other words, the board of directors of SpareBank 1 SMN has overarching responsibility for climate risk management through its approval of steering documents and follow-up of risk reporting. The risk and audit committee monitors the group's work on climate risk and submits its recommendations to the board of directors. Climate risk is reported on to the board of directors at least quarterly, including as a routine item in the risk report.

Day-to-day operations

The operational side of the business follows the ordinary lines-of-defence and responsibility structure. Inasmuch as climate risk is included in all steering documents, responsibility for climate risk management is an integral aspect of our business.

The group's ESG committee is tasked with the development and implementation of an overall methodology, process and group standard for sustainability at SpareBank 1 SMN. Climate

risk management is a part of this effort. All business lines in the group have a representative on the committee who is designated by the director of the business line or the head of subsidiary concerned. The committee's mission is to:

- Be a driver and facilitator of the further development, intensification and integration of sustainability in all business lines.
- Be a driver and facilitator of sustainable development among our customers, suppliers and the wider community.
- Coordinate activities and standards in the group and among joint ventures in SB1 Allianse.
- Develop expertise, frameworks, governance structures and culture.

Climate risk strategy³

SpareBank 1 SMN's climate risk strategy is designed to ensure good long-term profitability for the group.

- The long-term objective will be met by identifying, assessing and handling future climate risk related to the group's operations, primarily through being a driver of the green transition.
- The group will develop and maintain knowledge levels, tools and methodology for identifying climate risk both at customer level and in terms of quantifying risk at aggregate portfolio level.
- Credit policy and authorisations will be designed to form an effective framework for the lending business with a view to keeping the group's exposure to climate risk within the bounds of the board's stated risk appetite.
- The group will work proactively to reduce climate risk in the loan portfolio by providing advice, by funding transition and in the last resort by turning down customers who neither meet the minimum ESG requirements nor commit to transition.
- Risk related to financing of the bank's activities is reduced by the opportunity to issue green bonds.

Climate risk management will be integrated into the group's corporate governance. This involves taking climate risk into account in all the group's strategies, policies and procedures.

Ongoing work

At the start of 2022 the following work on integrating climate risk management is in progress.

- Development of an ESG classification tool in collaboration with the other SpareBank 1 banks.
- Mapping of climate risk exposure in the short, medium and long term for all key aspects of our business
- Updating of credit policy using insight gained from the mapping of climate risk
- Estimation of the loan portfolio's greenhouse gas emissions under the PCAF framework

³ The strategic guides give direction to our effort to implement climate risk action in our business and are not a description of action already taken at SMN.

- Mapping of risk-exposed properties (flooding, spring tides and landslides)
- Upgrading group employees' competence

An account of projects completed in 2021 is given in the annual report.