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CIBAFI BRIEFING

The Evolving Climate Change Landscape: Insights and Practical Experiences from Islamic Banks

CIBAFI is pleased to present its twenty-first "Briefing" on "The Evolving Climate Change Landscape: Insights and Practical Experiences from Islamic Banks". This briefing provides an overview of the evolution of climate risk management in Islamic finance, highlights how Islamic banks are managing climate-related risks, and presents case studies from Islamic banks in Malaysia, Nigeria, and Türkiye. It also emphasizes the unique approaches, successes, and challenges faced by these institutions in integrating climate risk management into their operations. The briefing also highlighted key innovative approaches and solutions for Islamic banks and underscored the importance of collaboration and knowledge sharing to enhance climate resilience within the Islamic finance sector.

1. Introduction

The growing challenge of climate change continues to impact societies and economies, posing significant risks to the financial sector.

For Islamic financial institutions (IFIs), climate risk mitigation is becoming a critical priority, as physical, transition, and liability risks can affect their stability and resilience. Therefore, addressing these risks is essential for long-term sustainability.

In recent years, CIBAFI has placed significant emphasis on the topic of climate change and its far-reaching implications for the Islamic financial industry. Two previous briefings highlighted the critical risks posed by climate change and the strategies needed to mitigate these risks. The first briefing in 2020, Climate Change and its Implications for the Financial Industry, discussed the environmental and socio-economic challenges of global warming, including physical and transition risks affecting financial institutions. It also explored international frameworks like the Paris Agreement, stressing the urgent need for coordinated action from financial stakeholders.

Building on this foundation, the second briefing in 2022, Climate Risk Stress Testing and its Implications for Islamic Banks, delved deeper into the application of stress testing as a tool for assessing climate-related risks. It discussed how stress testing frameworks, adapted for climate risks, can serve as a vital instrument in identifying vulnerabilities within IFIs. This briefing stressed the importance of incorporating both physical and transition risks into scenario analyses while recognizing the unique challenges Islamic banks face in adopting these methods.

The current briefing builds on CIBAFI's previous efforts by sharing practical experiences from Islamic banks on how they are managing climate-related risks. Drawing from the experiences of three Islamic banks, it aims to provide valuable insights into the specific climate risk management initiatives undertaken, the successes and challenges they encountered, and the lessons learned. To gather these insights, a methodology based on a qualitative research approach was used, with a structured open-ended questionnaire distributed to a select group of Islamic banks across diverse jurisdictions. This targeted selection was made to capture a range of practices within different regulatory and operational contexts, ensuring that the lessons and strategies derived are broadly applicable to the wider Islamic finance sector. By showcasing these experiences, we hope to offer actionable guidance and inspire other IFIs in their efforts to manage climate risks effectively.

2. Evolution of Climate Risk Management in Islamic Finance

The financial sector has experienced a surge in interest in climate risk management as climate change increasingly poses significant financial risks. Both physical risks, such as the destruction of assets due to extreme weather, and transition risks linked to the global shift towards net-zero economies have emerged as critical concerns. Regulatory bodies across the globe are recognizing the need for financial institutions to integrate climate-related risks into their core strategies to ensure long-term stability and resilience.

International regulatory authorities have taken a proactive role in shaping climate risk management. In Europe, the European Central Bank and the European Supervisory Agencies[1], alongside the U.S. Federal Reserve, have introduced stringent requirements for climate-related disclosures. These include stress tests and scenario analyses designed to prepare banks to manage and mitigate these risks effectively. However, an ongoing challenge remains the need for standardized metrics and benchmarking methodologies at the global level. Without such alignment, regulators face difficulties in consistently benchmarking climate change risks, which adds complexity to measurement and reporting processes. Establishing standardized methodologies would enable a more reliable comparison of climate risk data across jurisdictions and institutions, supporting regulators in conducting consistent assessments of climate exposure and enhancing accountability within the financial sector.

Complementing these regulatory efforts, global standard-setting bodies have introduced frameworks to guide financial institutions in sustainability disclosures. The International Sustainability Standards Board, which has taken over the responsibilities of the Task Force on Climate-related Financial Disclosures (TCFD) among other bodies, has issued two key standards: IFRS S1[2], which sets out general requirements for sustainability-related financial disclosures, and IFRS S2[3], which focuses specifically on climate-related disclosures. These standards ensure the consistent and comparable reporting of sustainability information, enhancing transparency and accountability for investors. Additionally, the International Auditing and Assurance Standards Board (IAASB) has approved the ISSA 5000[4] to enhance the rigor and consistency of sustainability assurance engagements, thereby strengthening the trust and confidence of investors, regulators, and other stakeholders in sustainability information (e.g., climate, labour, practices, biodiversity).

Furthermore, climate data availability is a widely recognized global issue. Reliable and comprehensive data is essential for climate risk assessment, but many financial institutions face challenges in accessing quality data, which affects their ability to model, stress test, and report climate risks accurately. Addressing this gap requires greater data-sharing initiatives, improved data infrastructure, and collaborative efforts across the financial sector and regulatory bodies.

Macroprudential frameworks are also evolving to address systemic risks posed by climate change. The Financial Stability Board through its 2023 Roadmap for Addressing Financial Risks from Climate Change[5], emphasizes global coordination in ensuring that financial institutions assess the climate change risks they face.

In parallel, the Islamic finance industry has recognized the growing importance of climate-related risks, particularly given that Islamic banks are predominantly concentrated in regions with above-average vulnerability to climate change. This heightened

1. European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA).
2. IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information (June 2023).
3. IFRS S2: Climate-related Disclosures (June 2023).
4. International Standard on Sustainability Assurance (ISSA) 5000: General Requirements for Sustainability Assurance Engagements (November 2024).
5. FSB: Roadmap for Addressing Financial Risks from Climate Change: 2023 Progress Report (July 2023).

exposure emphasizes the urgency for these institutions to adopt robust climate risk strategies that can safeguard their assets and portfolios. Some member countries of the Organization of Islamic Cooperation (OIC), such as Indonesia, Malaysia, Morocco, Saudi Arabia, the UAE, and Türkiye, have also adopted net-zero targets and integrated climate-related risks into banking supervision.[6] This is critical for managing transition risks and aligning Islamic finance with national climate objectives. Furthermore, several OIC countries have developed national climate adaptation strategies aligned with frameworks like the Cancun Adaptation Framework and the Paris Agreement, underscoring the central role of financing in achieving climate resilience.

Islamic finance regulators are drawing upon emerging global frameworks to bolster climate risk management. The Basel Committee on Banking Supervision has issued the "Principles for the Effective Management and Supervision of Climate-Related Risks[7]," which are being adopted by standard-setting bodies, including the Islamic Financial Services Board (IFSB). In 2023, the IFSB's revised "Guiding Principles on Corporate Governance for Islamic Financial Institutions" (IFSB-30)[8] integrated Shariah-compliant practices with international standards, aligning Islamic banks with global best practices, including those from the TCFD for enhanced climate-related disclosures.

Additionally, in 2024, CIBAFI developed a greenhouse gas (GHG) emissions measurement tool tailored to IFIs. This tool aligns with global efforts and provides specific guidance for Islamic banks to measure and report the GHG emissions associated with their financing and investment portfolios.

3. Case Studies from Islamic Banks

To better understand how Islamic banks are addressing climate risks, a qualitative research study was conducted through case studies. These studies reveal unique approaches, successes, and challenges as banks integrate climate risk management into their operations, offering valuable lessons for the broader Islamic finance sector.

Data was gathered through a structured open-ended questionnaire distributed to selected Islamic banks, covering comprehensive aspects of climate risk management including assessment, integration, mitigation, adaptation, offsetting, reporting, challenges, successes, and lessons learned. The questionnaire format enabled detailed responses that captured valuable insights into the sector's experiences and perspectives.

Three Islamic banks from diverse jurisdictions - Malaysia, Nigeria, and Türkiye - were selected for detailed analysis. While these jurisdictions cannot represent the complete spectrum of regulatory landscapes and practices across Islamic finance, they provide valuable insights into both common themes and notable variations in approaches to climate risk management.

6. WWF: SUSREG Annual Report: An Assessment of Sustainable Financial Regulations and Central Bank Activities (December 2023).

7. BCBS: Principles for the Effective Management and Supervision of Climate-Related Risks (June 2022).

8. IFSB: Revised Guiding Principles on Corporate Governance for Institutions Offering Islamic Financial Services – Banking Segment (December 2023).

Case Study 1: An Islamic Bank in Malaysia

In recent years, the bank has emerged as a prominent institution in climate risk management within the Islamic banking sector.

The bank has established a comprehensive framework that integrates climate risk considerations into all aspects of its operations. This case study explores the bank's initiatives, challenges, solutions, and lessons learned, providing valuable insights for other IFIs seeking to enhance their climate resilience.

A. Key Climate Risk Initiatives

The bank has initiated the development of sectoral heat maps to identify industries with high exposure to climate-related risks. It is also working on establishing a methodology for their assessment and organizing workshops to reflect the perspectives of relevant internal teams. These maps help the bank prioritize sectors and make more informed lending decisions, aligning its financing strategy with climate resilience.

1. Comprehensive Framework

The bank has established a robust Climate Risk Management Framework to embed climate risk considerations across all aspects of the bank's operations. This framework ensures robust governance, strategic alignment, and effective management of climate-related risks through the following key initiatives:

- Defining clear governance structures, roles, and responsibilities to manage climate-related risks across the bank, ensuring effective oversight and strategic direction.
- Driving the bank's business strategies to enhance resilience against climate-related risks, while staying within the approved risk appetite.
- Establishing robust processes for the identification, assessment, monitoring, and control of climate-related risks.
- Implementing climate risk scenario analysis and stress testing and integrating these results into the bank's capital adequacy assessments.
- Producing reliable and credible climate risk-related disclosures to provide transparency and accountability to stakeholders.
- Embedding climate-related risks into the bank's risk appetite framework, considering the potential long-term impact of these risks as drivers of existing material risks.
- Integrating material climate-related risk considerations into the bank's existing enterprise-wide risk management framework.
- Continuously enhancing data capabilities, tools, and methodologies to effectively aggregate and report material climate-related risks.
- Establishing appropriate risk controls for managing current and potential material climate-related risks, ensuring timely implementation of these controls.

- Implementing measures to address adverse effects from transition risks and mitigate potential build-up of climate-related risk concentrations, in line with the bank's risk appetite and business strategy.
- Producing reliable, meaningful, and comparable climate-related disclosures to support informed decision-making by stakeholders and reinforce the effective management of material climate-related risks within the financial sector.

Figure 1: Key Climate Risk Initiatives

2. Regulatory Alignment

The bank adheres to Bank Negara Malaysia's (BNM) guidelines for climate risk management, including the Climate Risk Stress Testing (CRST) framework, Climate Change and Principle-based Taxonomy (CCPT), and Climate Risk Management and Scenario Analysis (CRMSA) framework. The results from these frameworks are incorporated into the bank's internal reporting mechanisms and are regularly reviewed by senior management and the Board of Directors. This ensures that climate risk considerations are integrated into the bank's strategic decision-making processes and risk management practices.

Additionally, the bank ensures its climate-related disclosures adhere to international standards, such as the TCFD and the United Nations' Sustainable Development Goals, to enhance comparability and support informed decision-making by stakeholders.

3. Mitigating and adapting initiatives to climate change risks

The bank's efforts to mitigate and adapt to climate change risks are closely aligned with BNM's CCPT framework and guidelines. Key initiatives include implementing a Climate Change Classification and ESG Scorecard to identify high-risk sectors and manage risks within its Value-Based Intermediation (VBI)[9] approach. The bank prioritises financing projects supporting green and sustainable initiatives, reducing exposure to carbon-intensive industries. Scenario analyses are conducted to assess portfolio resilience, allowing them to adjust strategies proactively. Moreover, the bank engages with clients and stakeholders to promote climate-friendly practices and has set targets, such as achieving over 50% of financing in VBI assets, ensuring that less than 30% of new non-retail financing falls under CCPT watchlist categories, and actively managing exposure to CCPT carbon-emitting sectors. Regular reviews ensure alignment with CCPT and VBI principles, with progress monitored through key performance indicators and reported to senior management.

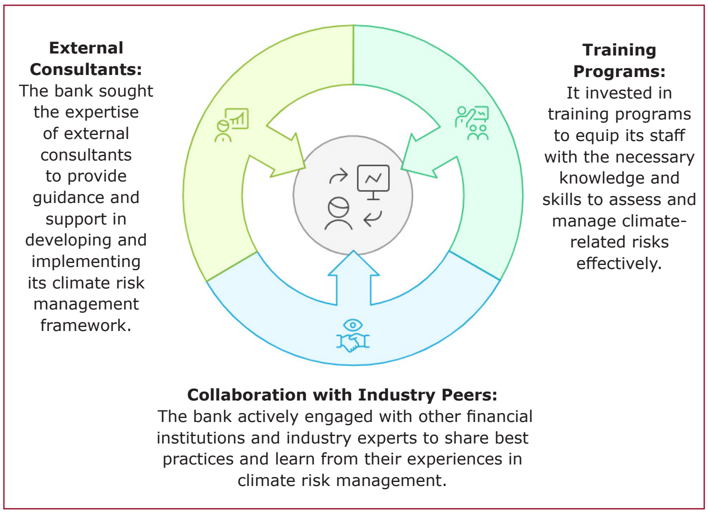
B. Challenges and Solutions

The bank shared that it has faced multiple challenges in implementing its climate risk management framework. These challenges included limited internal expertise, data availability, and navigating the evolving regulatory landscape.

1. Limited Expertise

The bank initially faced challenges due to limited internal expertise in climate risk management. To address this, the bank implemented several strategies:

Figure 2: Strategies to Overcome the Challenge of Limited Expertise

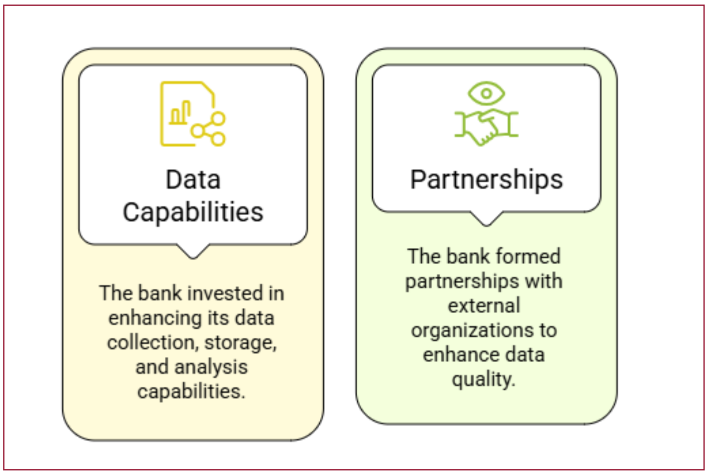


2. Data Availability

Accessing comprehensive and reliable data on climate-related risks was another challenge faced by the bank. To overcome this hurdle, the bank took the following steps:

9. Bank Negara Malaysia: VBI Financing and Investment Impact Assessment Framework - Guidance Document (2019).

Figure 3: Steps to Overcome the Challenge of Data Availability

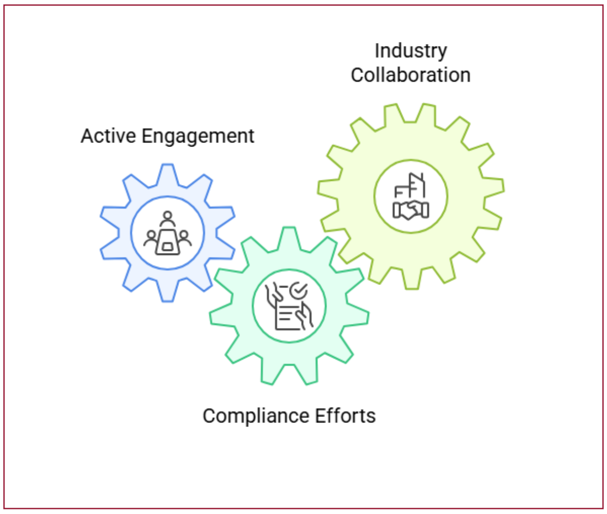


3. Regulatory Landscape

Navigating the evolving regulatory landscape surrounding climate risk management was another challenge faced by the Malaysian bank. To address this, the bank has undertaken several initiatives, including:

- Active Engagement: The bank actively engaged with BNM and relevant working groups and committees, for example Joint Committee on Climate Change, the BNM CRST Committee, the Physical Risk Working Group (PRWG) and Transition Risk Working Group (TRWG) to stay informed about the latest regulations and guidelines.
- Compliance Efforts: The bank implemented measures to ensure compliance with regulatory requirements, including conducting regular reviews and updates to its climate risk management framework.
- Industry Collaboration: The bank collaborated with other financial institutions to share experiences and best practices in navigating the regulatory landscape.

Figure 4: Initiatives for Adapting to the Changing Regulatory Landscape

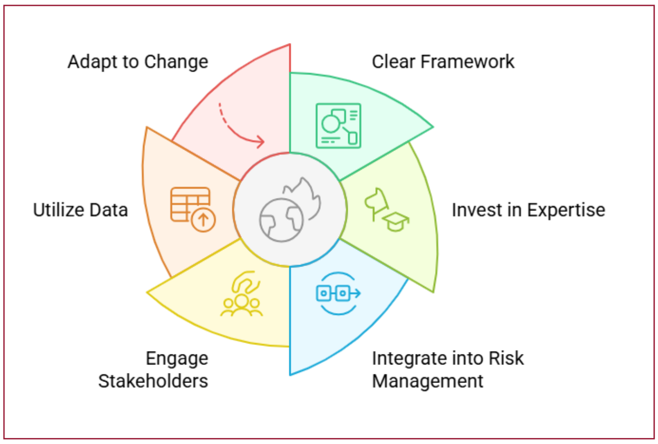


C. Key Lessons Learned

The bank's experience in implementing climate risk management has highlighted several key lessons. By applying these lessons, other IFIs can enhance their climate risk management practices and contribute to a more sustainable future. The key lessons include:

- Clear Framework: Develop a comprehensive framework tailored to specific needs.
- Invest in Expertise: Build internal expertise through training, collaboration, and partnerships with external consultants and climate risk experts.
- Integrate into Risk Management: Align climate risk management with overall business strategy, following guidelines such as BNM's CCPT and CRMSA frameworks.
- Engage Stakeholders: Foster relationships with clients and the community to promote collaboration and sustainable financing solutions.
- Utilize Data: Invest in data capabilities for effective risk assessment and reporting, with support from initiatives like the PRWG and TRWG.
- Adapt to Change: Remain adaptable to evolving regulations and market conditions, leveraging sustainable finance frameworks and industry collaborations for ongoing improvement.

Figure 5: Key Lessons Learned for Improving Climate risk Management



Case Study 2: An Islamic Bank from Nigeria

As a prominent Islamic financial institution in Nigeria, the bank has shown a commitment to incorporating climate risk management into its operations.

By adopting a structured approach that encompasses risk assessment, measurement, reporting, and mitigation initiatives, the bank has positioned itself to navigate the challenges posed by climate change. This case study explores the bank's initiatives, challenges, solutions, and lessons learned, providing valuable insights for other IFIs seeking to enhance their climate resilience.

A. Key Climate Risk Initiatives

The bank has shared multiple initiatives taken for climate risk mitigation. These initiatives demonstrate the bank's commitment to sustainable banking practices and responsible stewardship of the environment. The key climate risk initiatives are:

1. Comprehensive Risk Assessment

The bank has a structured approach which begins with risk identification. This involves recognizing both physical risks, such as those arising from extreme weather events and natural disasters, and transition risks, linked to regulatory changes and shifts in market preferences. By understanding the various dimensions of climate risk, the bank can better prepare for potential impacts on its operations and portfolios. Additionally, engaging external consulting firms for sustainability audit assurance further strengthens the institution's commitment to managing climate risks and overall sustainability practices.

2. Regulatory Measures

The bank adheres to the Nigerian Sustainable Banking Principles (NSBP) and the United Nations Environment Programme Finance Initiative (UNEP FI) frameworks. The NSBP ensures the integration of sustainability into operations by assessing both the financial viability and environmental impact of financed projects. Meanwhile, the UNEP FI frameworks provide methodologies for evaluating physical and transition risks, enabling the bank to conduct scenario analyses and stress tests. In addition to following guidelines from the Central Bank of Nigeria, the bank aligns with the Nigeria Climate Change Policy Response and Strategy.

3. Mitigating, Adapting and Carbon-offsetting Initiatives

The bank has developed frameworks to guide Environmental, Social and Governance (ESG) assessments for financing, refined through collaborations with external consultants. Key Performance Indicators tied to sustainability, one of the bank's strategic pillars, help ensure the effective implementation of climate-related risk management initiatives. These efforts are closely monitored at both management and board levels.

Additionally, the bank's carbon-offsetting initiatives are integral to reducing its carbon footprint, demonstrated by solar energy installations at offsite ATMs, branches, and the bank's headquarters. While Nigeria's carbon credit market is still in its early stages, the bank is committed to leading this market and supporting reforestation, renewable energy, and energy efficiency projects. By participating in the carbon credit market, the bank offsets emissions from its operations strengthens climate risk resilience, and contributes to the country's sustainable development efforts.

4. Stakeholder Communication

The bank discloses its climate risk assessment results through sustainability reports. These reports provide transparency and accountability to stakeholders, including clients, investors, and regulatory bodies.

B. Challenges and Solutions

The bank has faced several challenges in implementing its climate risk management framework, including a lack of internal expertise, underutilization of technology, and inadequate funding.

1. Knowledge Gap

One of the challenges faced by the bank in implementing climate risk management was a lack of internal expertise. To address this, the bank implemented capacity development programs to equip its staff with the necessary knowledge and skills. These programs covered topics such as climate change science, risk assessment methodologies, and sustainable finance principles. By investing in training and development, the bank was able to enhance its internal capabilities and ensure that its staff are well-equipped to manage climate-related risks effectively.

2. Underutilization of Technology

Another challenge faced by the bank was the underutilization of technology in climate risk management. To bridge this gap, the bank leveraged available resources and explored opportunities to adopt innovative technologies. This included investing in data analytics tools and other digital solutions that could enhance the bank's ability to assess and manage climate risks.

3. Inadequate Funding

One of the significant challenges faced by the bank was the inadequate funding available for green projects. To address this, the bank actively engaged with Development Finance Institutions (DFIs) that support Shariah-compliant, green projects. These DFIs provided financial assistance and technical support to the bank, enabling it to invest in sustainable initiatives and reduce its exposure to climate-related risks. By partnering with DFIs, the bank was able to access the necessary resources to implement its climate risk management strategies.

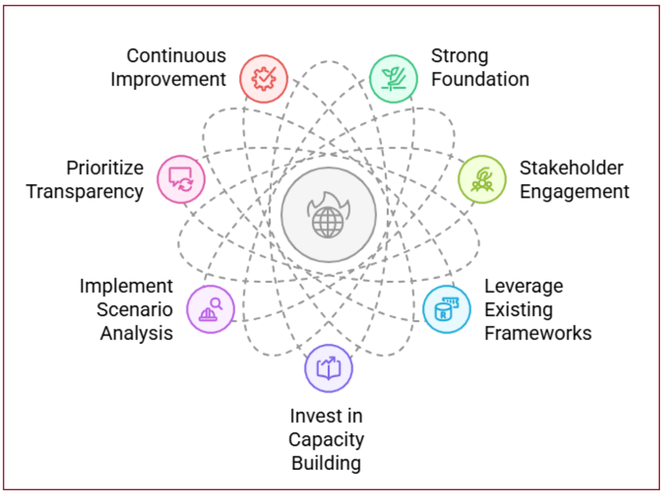
C. Lessons Learned

The bank identified the following key lessons from its experience:

- Strong Foundation: Start with a clear understanding of sustainable finance principles and how they align with Islamic finance. Integrating ESG factors into decision-making processes is critical.
- Stakeholder Engagement: Involve key stakeholders, such as clients, regulators, and community members, from the beginning. This fosters a shared sense of responsibility and helps shape a comprehensive climate risk management framework.
- Leverage Existing Frameworks: Utilize established guidelines like NSBP and UNEP FI guidelines to ensure your approach to climate risk management is aligned with best practices.
- Invest in Capacity Building: Train staff on climate risk assessment and sustainable finance. As a specific example, the involvement of employees in sustainability professional bodies – both locally and internationally – adds significant value to the bank's climate risk management journey.

- Implement Scenario Analysis: Conduct scenario analyses to understand potential climate impacts on portfolios. This proactive approach helps identify vulnerabilities and enables better risk mitigation strategies.
- Prioritize Transparency: Regularly communicate climate risk management strategies and outcomes to stakeholders. Transparency enhances trust and demonstrates a commitment to sustainability.
- Continuous Improvement: Stay updated on evolving trends, regulatory changes, and best practices in climate risk management to continuously refine and improve your strategies.

Figure 6: Key Lessons Learned from the Bank's Experience in Managing Climate Risks



Case Study 3: An Islamic Bank from Türkiye

As a leading Islamic bank in Türkiye, the bank has recognized the importance of integrating climate risks – both physical and transition – into its decision-making processes, aligning them with modern risk management practices.

This case study highlights the bank's approach to assessing, integrating, mitigating, and adapting to climate risks, along with the challenges faced and the lessons learned from its journey toward sustainability.

A. Key Climate Risk Initiatives

The bank has outlined a range of initiatives focused on addressing climate risks. These actions highlight the institution's resolve to promote sustainability in its operations and its proactive approach to environmental responsibility. The key climate risk initiatives are:

1. Integration of Climate Risks into Decision-Making

The bank has embedded climate risks into its decision-making processes by incorporating them into its risk inventory and governance structure. The bank assesses both physical and transition risks, factoring them into credit, market, operational, reputational, and strategic risk dimensions. This ensures a comprehensive understanding of how climate risks affect various aspects of the bank's operations.

2. Development of Sectoral Risk Heat Maps

The bank has initiated the development of sectoral heat maps to identify industries with high exposure to climate-related risks. It is also working on establishing a methodology for their assessment and organizing workshops to reflect the perspectives of relevant internal teams. These maps help the bank prioritize sectors and make more informed lending decisions, aligning its financing strategy with climate resilience.

3. Strategic Alignment with Sustainable Objectives

Climate risk considerations are integrated into the bank's strategic planning to ensure alignment with long-term sustainability objectives. Plans are underway to incorporate climate risk assessment into the credit evaluation process. The bank's Credit Policy defines the prohibition of financing for specific sectors and activities which harm the environment and society. In addition, a credit evaluation tool is aimed to be developed to measure ESG-related risks. These efforts will ensure that the bank's lending decisions fully reflect the potential impacts of climate change, thereby promoting more sustainable financial practices. Moreover, the bank is prioritizing financing for green projects, such as renewable energy and sustainable agriculture, to promote environmental sustainability. Strategic objectives are being monitored at the tactical level and in daily operations.

4. Enhanced Risk Measurement and Reporting

The bank employs several climate risk measurement and reporting frameworks to ensure effective identification, assessment, and communication of climate-related risks. A Sustainability Policy is overseen by the bank's Sustainability Committee, supported by six Working Groups. These groups identify climate risks and opportunities, analyse performance metrics, and ensure compliance with both national and international sustainability regulations. The bank aligns its methodologies with global standards such as the TCFD and the Network of Central Banks and Supervisors for Greening the Financial System (NGFS).

Additionally, the bank is preparing to comply with new Turkish regulatory requirements, including upcoming guidance from the Banking Regulation and Supervision Agency (BRSA) guidelines and the IFRS S1 and S2 standards. BRSA's draft guidance on climate-related financial risk management is anticipated to be finalized soon, and the bank aims for full compliance as it reviews and adjusts its frameworks and methodologies accordingly. Furthermore, BRSA's draft Green Asset Ratio Communiqué is steering the bank to increase its green finance concentration, prompting the development of new sustainable financial products. The bank has been growing its renewable energy financing selectively, contributing to its green finance portfolio. Moreover, the bank publishes detailed Sustainability Reports for stakeholders, outlining its climate risk strategies and mitigation efforts.

5. Mitigating and Adapting Initiatives

The bank has introduced several key initiatives aimed at addressing the financial and environmental impacts of climate change. These efforts focus on mitigating climate-related risks, promoting sustainable development, upholding the bank's commitment to ethical and responsible banking, and aligning with industry best practices. Key initiatives include:

- Financial Solutions: Offering financing solutions tailored for green projects, such as renewable energy, energy efficiency, and sustainable agriculture, promoting environmentally friendly practices.
- Green Sukuk: Issuing the first green Sukuk in Turkey to raise funds for environmentally beneficial projects, ensuring that proceeds are allocated to initiatives that mitigate climate risks.
- Risk Assessment Framework: Establishing a framework for assessing climate risks across the bank's portfolio, integrating these assessments into its credit evaluation and investment decision-making processes.
- Regulatory Alignment: Continuously monitoring regulatory developments and aligning the bank's initiatives with international standards and frameworks to ensure that the bank's practices remain relevant and effective.
- Adoption Strategy: Developing and implementing adaptation strategies that focus on enhancing the resilience of the operations and portfolio against the impacts of climate change, ensuring long-term sustainability.

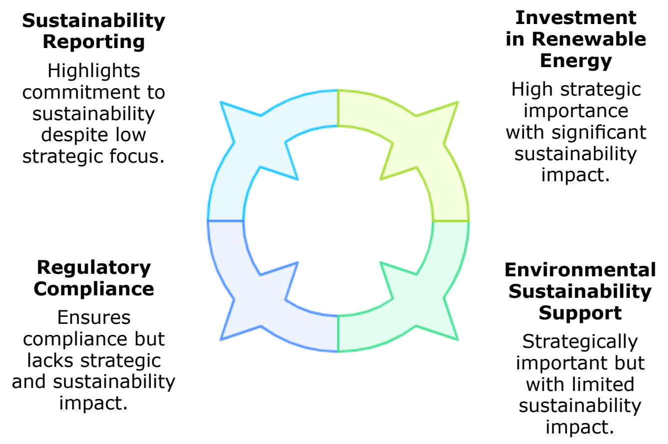
Figure 7: Mitigating and Adapting Initiatives

6. Carbon-offsetting Initiatives

Carbon-offsetting initiatives play a significant role in the bank's overall climate risk management strategy. To support effective carbon offset projects, the bank has prioritized strengthening the bank's GHG inventory system over the past two years. This work has focused on enhancing infrastructure for measuring both direct emissions and, more recently, downstream emissions. The bank has also set short-, medium-, and long-term targets in its Sustainability Strategy Plan.

Key initiatives of carbon offsetting are presented in the figure below:

Figure 8: Carbon-Offsetting Initiatives



B. Challenges and Solutions

The bank encountered several challenges in implementing its climate risk management framework. These challenges included access to high-quality climate data, evolving regulatory landscape, and balancing short-term financial pressures with long-term sustainability goals. Key challenges and solutions include:

1. Access to High-Quality Climate Data

The bank faced challenges in acquiring reliable data for accurate climate risk assessment. To overcome this, the bank is utilizing publicly available information from reputable organizations specializing in climate projections and risk assessments, while also exploring potential areas of collaboration with its key partners.

2. Changing Regulatory Landscape

The evolving regulatory landscape created some challenges around compliance with climate-related standards. The bank proactively addressed this by closely monitoring regulatory developments from the BRSA and Public Oversight Authority. Regular participation in workshops helped the bank stay ahead of regulatory changes and adapt its strategies.

3. Integration of Climate Risk into Traditional Risk Frameworks

Integrating climate risks into established risk management frameworks was complex, requiring a cultural and procedural shift within the organization. The bank adopted a phased approach, starting with senior management's endorsement of climate risk governance and gradually embedding climate considerations into core business operations.

4. Balancing Short-Term Financial Pressures with Long-Term Climate Goals

One of the key challenges for the bank was maintaining a commitment to long-term climate risk management amid short-term financial pressures. To address this, climate risk management was integrated into the bank's strategic planning, ensuring that it remains a priority. Regular progress updates to senior leadership helped keep the focus on climate resilience.

C. Key Lessons Learned

The bank's experience highlights several critical lessons in managing climate risks effectively. Key takeaways include:

1. Governance is Key

The bank has established a robust governance structure that incorporates climate risk at all levels is essential to have clear accountability and responsibilities regarding climate risk management, aligning it with the bank's overall strategic objectives.

2. Importance of Sector-Specific Risk Assessment

Creating sector-specific risk heat maps will enable the bank to tailor its strategies to different industries, ensuring a more targeted approach to managing climate risks. This approach will eventually enhance decision-making, particularly in high-risk sectors.

3. Alignment with Global and Local Standards

The bank has initiated its efforts and made progress to align its climate risk management with global frameworks such as the TCFD and local regulations, including the Turkish Sustainability Reporting Standards (TSRS S1 and TSRS S2). This alignment will enable the bank to maintain compliance while adopting best practices, ultimately enhancing its resilience and reputation in the market.

4. The Role of Sustainable Financing

Actively seeking opportunities to finance environmentally sustainable projects and businesses aligns with the ethical and social objectives of Islamic banking. By investing in green projects and issuing Green Sukuk, the bank has not only strengthened its financial position but also positioned itself as a leader in sustainable finance within the Islamic banking sector, aligning with both climate resilience and Islamic banking principles.

5. The Value of Carbon Offsetting

The bank's experience with carbon-offset projects highlighted the importance of reducing the bank's carbon footprint and aligning with sustainability goals. These initiatives contributed to long-term environmental benefits and improved stakeholder confidence in the bank's commitment to addressing climate change.

6. Collaborative Partnerships for Success

The bank actively engages in partnerships with other financial institutions, including banking unions, to share best practices, experiences, and resources in climate risk management. By collaborating with consultants and experts in climate-related financial risks, the bank is able to rapidly integrate sustainable practices into its business strategies. These partnerships enable the bank to better anticipate and mitigate potential impacts on financial performance and long-term viability.

7. Stakeholder Engagement

The bank formed several working groups, within the bank, to foster collaboration and a shared understanding among business departments, ensuring alignment in climate risk mitigation strategies. Engaging experts, regulators, and other stakeholders has also proven crucial for staying informed about the best practices in climate risk management.

4. Common Themes and Challenges

The case studies reveal several recurring challenges faced by Islamic banks in managing climate risks. Despite diverse geographic locations and operational frameworks, many banks encounter similar difficulties. The case studies highlight the significance of a comprehensive framework for climate risk management, emphasizing the need for a holistic approach. Additionally, Islamic banks faced challenges related to limited internal expertise, data availability, and navigating the evolving regulatory landscape.

Moreover, a key insight from the case studies is the significant influence of local regulators in shaping banks' climate risk management practices. The respective regulatory bodies are playing a proactive role in driving the development of banks' risk management frameworks and reporting standards. This collaboration is observed as an essential source of information and strategic alignment, enabling banks to more effectively navigate climate risk management within a structured framework that aligns with both national and international standards.

A. Key Common Themes and Challenges

Below are the recurring themes and challenges derived from the case studies that underscore the importance of proactive measures to address climate risks and ensure the long-term sustainability of IFIs. Considering these issues, Islamic banks can strengthen their resilience and contribute to a more sustainable future.

Comprehensive Framework

Most banks have established or are working towards comprehensive climate risk management frameworks, often driven by their regulators. However, challenges arise in tailoring these frameworks to address each bank's unique operational and strategic needs effectively.

Regulatory Landscape

The challenges of navigating the evolving regulatory landscape surrounding climate risk management and ensuring compliance with changing guidelines.

Internal Expertise

Islamic banks face a shortage of in-house climate risk expertise. While training programs and collaborations with external consultants have been beneficial, there remains a need for long-term capacity building and expertise development within the industry.

Data Availability

Obtaining high-quality, reliable data for climate risk assessments remains a challenge, especially for smaller institutions and those in developing regions. The lack of comprehensive climate data can limit the effectiveness of risk mitigation strategies.

Stakeholder Engagement

The value of fostering relationships with stakeholders to build trust, gain valuable insights, and ensure that climate risk management efforts are aligned with their needs and expectations.

5. Innovative Approaches and Solutions

This section aims to highlight the innovative approaches and solutions adopted by respondent Islamic banks in addressing common challenges related to climate risk management. By identifying these creative strategies, we can explore potential best practices that can be adopted by other financial institutions within the industry.

A. Key Innovative Approaches:

Comprehensive Framework	Banks like Malaysian and Turkish institutions have developed robust climate risk management frameworks that integrate climate considerations into decision-making processes, covering governance, scenario analysis, and risk disclosure.
Internal Expertise	Islamic banks, from Malaysia and Nigeria, invested in extensive training programs to build internal expertise in climate risk management.
Data Capabilities	Some banks have invested heavily in enhancing data capabilities, such as building partnerships with external data providers to improve the quality of climate risk data. This allows for more accurate risk assessments and better-informed decision-making.
Sectoral Risk Heat Maps	A novel approach by a Turkish bank involves creating sectoral risk heat maps to identify industries with high exposure to climate-related risks. This tool enables better prioritization in lending decisions and aligns financing strategies with climate resilience. The Malaysian bank appears to be achieving the same end with a slightly different tool.
Green Sukuk	The Islamic bank from Türkiye has issued Green Sukuk to fund environmentally friendly projects. This aligns Shariah-compliant finance with sustainability goals, enabling Islamic banks to contribute directly to climate mitigation efforts.
Stakeholder Engagement	All banks are actively engaging stakeholders, such as clients, regulators, investors, and local communities, to enhance transparency and build trust in their climate risk management efforts. By fostering dialogue and collaboration, Islamic banks can better align their sustainability objectives with stakeholder expectations, enhancing their overall resilience and social impact.

B. Potential for Collaboration and Shared Solutions

The case studies highlight the potential for collaboration and shared solutions within the financial industry. By sharing best practices and experiences, banks can collectively enhance their climate risk management capabilities and contribute to a more sustainable future.

Figure 9: Potential Areas of Collaboration

Knowledge Sharing	Joint Initiatives	Advocacy Efforts
IFIs can collaborate to share knowledge and best practices related to climate risk management, as well as the development of innovative products and solution.	IFIs can develop joint initiatives to address common challenges, such as data sharing or the development of standardized methodologies.	IFIs can collaborate to advocate for policies and regulations that support sustainable finance and climate risk management.

6. Conclusion

The analysis of case studies demonstrates that Islamic financial institutions are actively evolving to meet the climate challenge through innovative approaches and systematic risk management.

The experiences of banks across different jurisdictions - from Green Sukuk issuance to sophisticated climate scenario analysis - show how Islamic finance principles can align with and enhance sustainable development goals.

What emerges most clearly is that climate risk management in Islamic banking is not just about risk mitigation, but about transforming business models to capture new opportunities. The banks studied are moving beyond compliance to pioneer new products, develop enhanced analytical capabilities, and forge strategic partnerships that position them at the forefront of sustainable finance.

Looking ahead, Islamic banks have a unique opportunity to leverage their ethical foundations and community-focused approach to lead in sustainable finance innovation. Their experience with risk-sharing models and emphasis on real economy activities provides a natural framework for developing climate-resilient financial solutions.

The future success of climate risk management in Islamic finance will depend on the industry's ability to:

- Transform climate challenges into opportunities for financial innovation
- Use technology to enhance risk assessment while maintaining Shariah compliance
- Build on existing ethical principles to develop new sustainable finance products
- Lead in setting standards for climate risk management that bridge conventional and Islamic approaches

Through these efforts, Islamic financial institutions can help shape a financial system that is both sustainable and equitable, contributing to a more resilient global economy while staying true to their founding principles.

CIBAFI BRIEFING

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About CIBAFI

CIBAFI is an international non-profit organisation founded in 2001 by the Islamic Development Bank (IsDB) and a number of leading Islamic financial institutions. CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC). With over 140 members from more than 30 jurisdictions from all around the world, CIBAFI is recognised as a key piece in the international architecture of Islamic finance. Its mission is to support the Islamic financial services industry's growth by providing specific activities and initiatives that leverage current opportunities while preserving the value proposition of Islamic finance. CIBAFI is guided by its Strategic Objectives, which are 1) Advocacy of Islamic Finance Values and Related Policies & Regulations; 2) Sustainability and Innovation Integration; 3) Industry Research and Analysis; and 4) Professional Development.

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