FOCUS NOTE

CGAP

CLIMATE ADAPTATION, RESILIENCE, AND FINANCIAL INCLUSION

A new agenda

EXECUTIVE SUMMARY

November 2023

Peter Zetterli

Acknowledgments

This Focus Note is based on the work of a CGAP team consisting of Silvia Baur-Yazbeck, Wendy Chamberlin, Peter Knaack, Sabaa Notta, and Lusine Stepanyan, led by Peter Zetterli. The author would like to express his warmest gratitude to the entire team for their dedication, intellectual rigor, and spirited collaboration, without which this report would never have been possible. Sincere thanks also go to other CGAP staff who have contributed in critical ways, including Jahda Swanborough on thorny substantive discussions, Melinda Wood on communications aspects, and Claudia McKay on overall guidance. Particular appreciation goes to the external peer reviewers for their invaluable perspectives, including Graham Wright at MicroSave, Andrée Simon and Cassandra Johnson at FINCA, and Loreta Rufo and Chitembo Kawimbe Chunga at the Climate Investment Funds. Thanks also to CGAP's internal reviewers: Sophie Sirtaine, Ivo Jeník, Alexander Sotiriou, and Michel Hanouch.

CGAP

1818 H Street NW, MSN F3K-306
Washington, DC 20433 USA
Internet: www.cgap.org
Email: cgap@worldbank.org
Telephone: +1 202 473 9594

Cover photo by Allison Shelley for CGAP, 2017 (Santa Odongo, 39, collects cotton on the family farm in Adyaka town in the Lira district of the Northern Region of Uganda).

© CGAP/World Bank, 2023

Rights and Permissions

This work is available under the Creative Commons Attribution 4.0 International Public License (https://creativecommons.org/licenses/by/4.0/). Under the Creative Commons Attribution license, you are free to copy, distribute, transmit, and adapt this work, including for commercial purposes, under the terms of this license.

Attribution—Zetterli, Peter. 2023. "Climate Adaptation, Resilience, and Financial Inclusion: A New Agenda." Focus Note. Washington, D.C.: CGAP. https://www.cgap.org/research/publication/climate-adaptation-resilience-and-financial-inclusion-new-agenda.

Translations—If you create a translation of this work, add the following disclaimer along with the attribution: This translation was not created by CGAP/World Bank and should not be considered an official translation. CGAP/World Bank shall not be liable for any content or error in this translation.

Adaptations—If you create an adaptation of this work, please add the following disclaimer along with the attribution: This is an adaptation of an original work by CGAP/World Bank. Views and opinions expressed in the adaptation are the sole responsibility of the author or authors of the adaptation and are not endorsed by CGAP/World Bank.

All queries on rights and licenses should be addressed to CGAP Publications, 1818 H Street, NW, MSN F3K-306, Washington, DC 20433 USA; e-mail: cgap@worldbank.org.

EXECUTIVE SUMMARY

Financial inclusion should be a cornerstone of climate action

Financial inclusion[1] can play a critical role in enabling autonomous adaptation and building grassroots resilience to climate change. Building resilience against the devastating effects of a warming climate is impossible without access to savings, lending, payments, and insurance solutions that help households and businesses to prepare for, cope with, and recover from increasingly intense and unpredictable climate shocks and stresses. Financial inclusion can hence bolster climate resilience in low-income communities that are the least responsible for climate change emissions yet tend to be more exposed and vulnerable to their effects. Access to the right financial services can be particularly important in empowering women and girls, who, as a group, often play a critical role in the adaptation and resilience of communities but are more exposed and vulnerable to climate risk as well as more excluded from the tools needed to manage it.

By enabling the poorest and most vulnerable people to pursue their own resilience strategies, an inclusive financial system is a fundamental enabler of adaptation and an absolute necessity for a just transition.[2] It should be a cornerstone of action on climate adaptation.[3] CGAP is therefore outlining a new agenda for global collaboration on financial inclusion, climate adaptation, and resilience.

Financial services are not fully delivering for climate adaptation

Despite their potential for supporting widespread climate adaptation, financial services far from fulfil this role at the moment. The immediate reason is the gap between those with access to financial services and those without; despite the significant progress made over the last decade, 1.4 billion adults remain excluded from the financial system. More than 80 percent of them live in the most climate vulnerable countries, many of which also have few resources, minimal infrastructure, and limited capacity to withstand and recover from climate shocks (UNSGSA 2023).

1 CGAP defines financial inclusion as the state where all individuals and enterprises have access to and are empowered to use affordable, responsible financial services—such as payments, savings, credit, and insurance—that meet their needs. For more on how we define key terms, please refer to the Glossary included in the Focus Note.

2 The term "just transition" is typically used to denote a set of principles, processes, and practices that aim to ensure that no people, workers, places, sectors, countries, or regions are left behind in the transition from a high-carbon to a low-carbon economy.

3 "Autonomous adaptation" refers to the adaptive measures spontaneously taken by individuals, households, and small firms as opposed to the planned adaptation response undertaken by government entities.

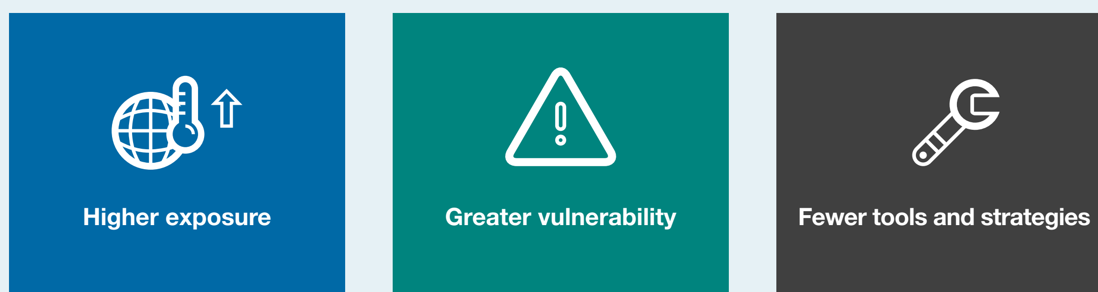
Moreover, generic financial products and services may not be fit for responding to climate change. Even people with access to financial services mostly lack solutions specifically designed to bolster climate adaptation and resilience. The magnitude of harm the world's poorest and most vulnerable communities face means every opportunity to support them must be exhausted. Yet as revealed in the more than 100 interviews CGAP held with financial services providers, few offered or were trying to develop solutions designed for climate adaptation and resilience building.

Financial service providers cited a variety of reasons for their lack of effort on climate adaptation, including a poor understanding of client needs, lack of data, and weak organizational capacity on climate change. Many also raised questions about the business case, as adaptation investments can be hard to value, have lengthy time horizons, and often do not generate revenue that can be put toward loan repayments. Hence financial services providers need help developing a broader suite of solutions for climate adaptation and resilience. Identifying, testing, and scaling effective solutions will require more support and closer collaboration between stakeholders working on climate change and financial inclusion.

Women's needs must take center stage

Women typically play a major role in building climate resilience at the household level and beyond. Women and girls are also often more exposed and vulnerable to climate risk. For example, women disproportionately work in heavily climate-exposed livelihoods such as agriculture; girls are often the first to be taken out of school during times of economic hardship; and women and girls typically have less access to financial accounts, loans, and insurance products. At the same time, social norms and societal structures often result in women having less access to the tools they need to manage climate change, including financial services. As climate change worsens, it could also undermine the considerable progress made on women's financial inclusion, women's economic empowerment, and, by extension, the achievement of wider global development goals.

FIGURE 1. **Key dimensions of gender inequity in climate change adaptation and resilience**



Source: Notta and Zetterli 2023.

This underscores the importance of applying a gender lens to work on climate adaptation, resilience, and financial inclusion. Thus far, too little work has been done at the intersection of these topics. While large bodies of research now exist on gender and financial inclusion as well as on gender and climate adaptation, little academic or other work combines all three. Similarly,

within development organizations, teams working on gender increasingly engage with those working on financial inclusion and climate change—but rarely both at the same time.

Climate change undermines financial inclusion

Inclusive finance centers on extending financial access to low-income, informal clients who are often challenging, expensive, and fundamentally risky to serve. As the effects of climate change grow more frequent, severe, and unpredictable, the costs and risks associated with serving these clients are now rising. Climatic shocks and stresses are damaging the homes, farms, and other assets normally used for collateral, undermining livelihoods and weakening the income streams used to pay for financial services, and at the same time increasing operational costs for providers. As a result, financial services providers will be forced to pull back from value chains and geographical areas that are particularly exposed and vulnerable to climate change as certain markets grow increasingly less viable. In fact, CGAP's research shows this is already happening in both high- and low-income countries.

Financial services providers also increasingly wrestle with climate risk of their own. Major weather events can force branches to close, prevent loan officers from seeing clients, take down digital channels, and disrupt agent networks. Lenders in areas affected by natural disasters may see substantial portions of their portfolios wiped out overnight. Replenishing the balance sheet after such an event requires investors to bear part of the burden, which they may not always be prepared to do. After the destructive floods in Pakistan, for example, financial services providers suffered major losses that raised difficult questions—not just for the present but for the future. As one CEO noted, "How can we continue operating unless we can insure ourselves against the risk of this happening again?"

Helping inclusive finance providers manage climate risk must therefore be a major priority for funders that care about either financial inclusion or climate adaptation. While much of the risk would ideally be transferred to international insurance markets, such solutions so far tend to be unavailable or unaffordable for financial services providers serving low-income segments. Beyond insurance, there is the need for blended finance solutions, credit guarantees, and other forms of risk-sharing by public and philanthropic capital for inclusive financial services providers to have the ability to keep serving poor people as climate risks and impacts rise.

Green finance efforts must prevent unintended exclusionary effects

Like direct climate risks, the necessary regulatory responses to climate change could also exacerbate financial exclusion if not carefully designed. CGAP's interviews with financial authorities[4] in 14 countries showed that many are developing new rules and strategies for climate change and the greening of the financial system. This effort is vital but could create

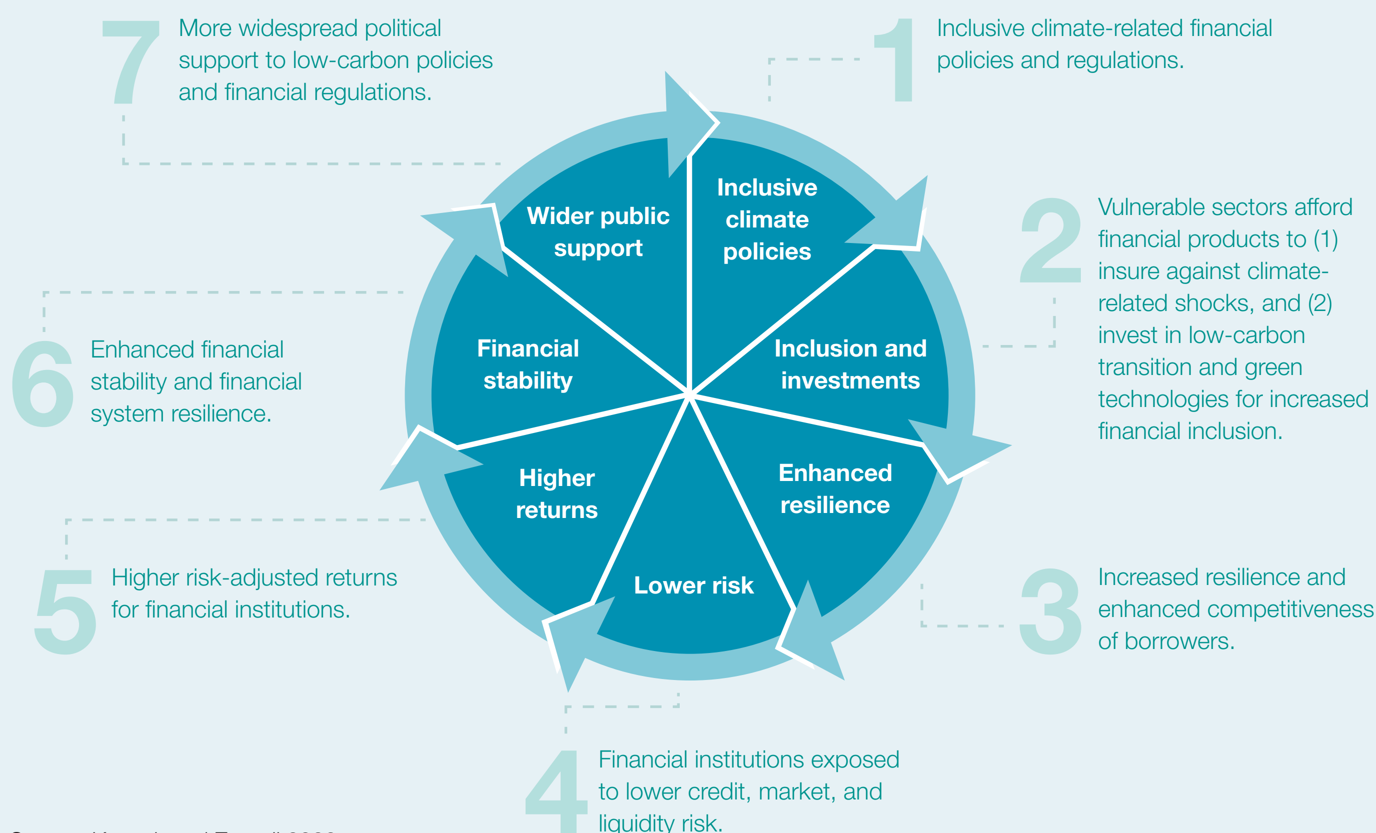
4 For the sake of brevity, the term "financial authorities" is used here to refer to the combination of policy makers, regulators, and supervisors charged with ensuring financial system stability.

unintended knock-on effects. For example, transaction costs associated with environmental due diligence may be disproportionately high for smaller loans, pricing out low-income clients.

Clients whose financial access is curtailed will be less able to invest in climate adaptation and resilience, which increases the vulnerability of the real economy and has ramifications for financial stability. This may create a downward spiral of shrinking financial access, falling climate resilience, and weakened financial sector stability. Very few of the financial authorities CGAP interviewed had considered these potential effects. Given the sense of urgency and momentum surrounding regulatory responses to climate change, this raises concerns that new rules and standards which unintentionally exacerbate financial exclusion could be rushed into place.

Yet it does not have to be this way; inclusive policy and regulatory action can instead create a virtuous cycle where expanded access to financial services helps more people manage climate risk, reducing climate impact on the real economy and increasing financial stability. This does not need to slow down the regulatory response to climate risk. It requires only that financial authorities explicitly consider the potential effects on financial inclusion and respond in a proportional manner.

FIGURE 2. **The virtuous cycle of green resilience and supporting policies**



Source: Knaack and Zetterli 2023.

Public and philanthropic capital have both direct and indirect roles to play

The development community has a crucial role to play in helping to make financial offerings more relevant for climate adaptation and resilience as well as in protecting and sustaining global progress on financial inclusion in the face of climate risk. By driving innovation and scale in climate-responsive financial solutions, public and philanthropic funders can help address the risks that climate change pose for financial inclusion while also developing new sources of opportunity for financial institutions and their clients around climate adaptation.

As always, the first priority should be to catalyze and extend commercial markets as far as they can reach by building capacity, supporting experimentation, sharing risk, and scaling models that work. By strategically deploying their resources using a market systems approach, public funders can mobilize private capital and entrepreneurial effort to meet the climate adaptation and resilience needs of millions. This is essential since the resources of governments and their development partners will not be nearly enough to finance necessary investments in climate adaptation, which the United Nations estimates at up to $340 billion by 2030 (UNEP 2022).

However, millions of people will remain too poor to afford fully commercial prices. It will fall on public and philanthropic capital to fill this gap and directly support low-income populations in accessing the financial solutions they need. This will require a range of interventions to bring down the cost of delivering and consuming the needed financial services. For example, extending insurance cover against major climate risks to the poorest and most vulnerable population segments will likely require subsidies. If appropriately deployed, such interventions could help drive economies of scale that expand the reach of commercially-provided products and services over time.

Governments and funders also need a new focus on using social protection systems to support climate adaptation. Social protection systems offer an existing mechanism to reach the most vulnerable and have many characteristics that make them well placed to deliver adaptation finance where it is most needed. But they will also need to be appropriately designed and resourced to deliver on climate objectives. Despite progress on this front, CGAP's review of the current state of adaptive social protection indicates there is still a long way to go in using such systems to build longer-term climate resilience and support adaptation to slow-onset climate stresses. Integrating financial services as part of graduation-style economic inclusion efforts[5] can play a central role in this.

All of these strategies will require significant resources but should ultimately comprise a cost-effective approach to climate finance. It is well known in disaster risk finance that building resilience as a preventative step can reduce subsequent losses from a disaster by several multiples. In the context of global loss and damage debates that will only grow more vocal as climate change intensifies, spending money wisely today will likely prove a good investment tomorrow.

5 See, for instance, Hashemi and Montesquiou 2011.

Toward a new agenda

To deliver all of these solutions, the global development community needs a new agenda that spans climate change and financial inclusion. This Focus Note highlights a series of complex challenges that are not easily solved in isolation. From developing the right analytical tools and frameworks to implementing specific policies, regulations, financing instruments, and financial services, much work lies ahead.

FIGURE 3. **Five key categories of funder interventions**

CGAP's early insights point to multiple opportunities for financial services providers and their investors, financial regulators and standard-setting bodies, governments and their development partners, civil society organizations, and philanthropic funders. All have important roles to play and need to collaborate effectively to rise to the challenge. Crucially, this includes learning to work more closely across financial inclusion and climate change, which may be easier said than done.

As CGAP research on funders has shown, even within a single organization thematic siloes are often so strong that cross-collaboration is rare and opportunistic rather than systematic and strategic. But recognizing and deepening the role of inclusive finance in climate adaptation is crucial—not only for financial inclusion practitioners but for researchers, policy makers, practitioners, and activists driving the climate agenda as well.

Based on a year of CGAP research, this Focus Note combines fresh empirical evidence, rigorous analysis, and a deep understanding of financial services to present a compelling call to action and a new agenda for each set of key stakeholders to consider.

References

Hashemi, Syed, and Aude de Montesquiou. 2011. "Reaching the Poorest: Lessons from the Graduation Model." Focus Note. Washington, D.C.: CGAP, March. https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Reaching-the-Poorest-Lessons-from-the-Graduation-Model-Mar-2011.pdf.

Knaack, Peter, and Peter Zetterli. 2023. "Climate Risk and Financial Inclusion: A Regulatory Perspective on Risks and Opportunities." Working Paper. Washington, D.C.: CGAP, August. https://www.cgap.org/research/publication/climate-risk-and-financial-inclusion-regulatory-perspective.

Notta, Sabaa. 2022. "State of the Climate-Responsive Financial Product Landscape." Blog. Washington, D.C.: CGAP, 7 December. https://www.cgap.org/blog/state-of-climate-responsive-financial-product-landscape.

Notta, Sabaa, and Peter Zetterli. 2023. "Bolstering Women's Climate Resilience and Adaptation Through Financial Services." Working Paper. Washington, D.C.: CGAP, June. https://www.cgap.org/sites/default/files/publications/WorkingPaper_WomensClimateResilience_v3.pdf.

UNEP. 2022. "Adaptation Gap Report 2022." UNEP-FI, October. https://www.unep.org/resources/adaptation-gap-report-2022.

UNSGSA. 2023. "Inclusive Green Finance: A Policy and Advocacy Approach." Policy Note. New York: United Nations, May. https://www.unsgsa.org/sites/default/files/resources-files/2023-05/UNSGSA_Inclusive_Green_Finance_Policy_Note.pdf.

CGAP
cgap.org