The Chancery Lane Project

Toolkit

Climate risk and financial services

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This toolkit helps practitioners identify and structure climate risks. It is not a compliance checklist but a framework to guide professional judgment, with a deliberate focus on physical and transition risks to highlight their growing relevance in everyday legal practice.

Understanding climate risk in the financial services

Climate risk is identifiable, quantifiable and - crucially - reasonably foreseeable. Financial institutions are already feeling the impact through mispriced assets, stranded investments, and abrupt regulatory shifts. Climate-related financial risk is being treated as financial risk.

Transition risks are materialising through policy shifts, regulatory developments (such as the UK's SDR regime and ISSB-aligned disclosure rules), market revaluation of carbon-intensive assets, and rising scrutiny of greenwashing and financial institutions' own approaches to the transition to net-zero. Meanwhile, **physical risks** - from flooding to wildfires - threaten the value and security of real-world collateral.

Case 1: Portfolio Misalignment

A UK institutional lender finances commercial property across South-East Asia. Rising sea levels and intensifying storm patterns increase physical damage risk, triggering rising insurance costs and vacancy rates. Asset values drop - hitting the lender's capital adequacy metrics.

Developed with the support of AI under the author's framework and editorial direction, this toolkit has been peer-reviewed by senior practitioners in the field to ensure its practical relevance and professional integrity.

Case 2: Financed emissions exposure

A bank's large lending book includes oil and gas exploration. Regulatory scrutiny and shareholder pressure force the bank to disclose its financed emissions. The result: reputational fallout, investor withdrawal, and the need for rapid portfolio transition - at a cost.

Impacts and legal consequences

Climate risk is increasingly giving rise to both legal and operational challenges for financial institutions and their advisers. Institutional investors, in particular, are now expected to account for climate risk in their portfolio decisions and stewardship activities. A failure to do so may result in legal claims, especially where fiduciary duties are interpreted in light of long-term financial sustainability. Disclosure obligations are also becoming more demanding, with frameworks such as TCFD, ISSB and the EU's CSRD requiring far greater transparency and rigour in climate-related reporting. Where statements are misleading, exaggerated or incomplete, the risk of greenwashing allegations is heightened.

Climate considerations are also shaping the interpretation and enforcement of contractual terms. Climate-related losses or failures to meet ESG-related undertakings can trigger breaches of covenants, warranties or indemnities. Operationally, firms face growing complexity, from ensuring data quality and building climate models to meeting the expectations of increasingly active supervisors. Public and media scrutiny of financial actors is intensifying, and reputational damage can follow quickly - whether due to perceived inaction, contradictory practices, or communications seen as disingenuous.

At the same time, climate litigation is on the rise. Legal actions are emerging across jurisdictions, often centred on inadequate disclosure, poor due diligence, or failure to act on climate risks. Institutions with concentrated exposure to carbon-intensive sectors or regions vulnerable to physical climate impacts may also face questions about asset quality and risk-weighted capital requirements.

Insurance and indemnity arrangements are shifting in response to these dynamics, with higher premiums, narrower coverage and ambiguity over liability in the event of climate-related losses all contributing to an increasingly complex risk landscape.

Practical tools for risk management

Contracts can - and should - be used to allocate risk, enable collaboration, and drive decarbonisation. The opportunity lies in proactive design.

1. **Pre-contract**

    a. **Due diligence:** Integrate climate assessments into client, project and asset-level diligence. Include analysis of financed emissions, physical resilience, and climate transition plans. Consider direct risks (those risks directly affecting the counter-party) and indirect risks (risks that occur along the counter-party's value chain).

    b. **Assess alignment with net-zero strategy:** Consider climate impacts on creditworthiness and long-term asset viability.

    c. **Review third-party disclosures:** Look for greenwashing indicators or omissions. Does their transition plan align with your transition plan?

    d. **Risk management**: Integrate identified climate-related risks into risk management frameworks and contractual decision making processes. Can identified risks be managed or mitigated?

2. **Contracting**

    a. **Warranties and covenants:** Include sustainability-linked warranties, emissions reporting requirements and compliance with relevant climate frameworks, but recognise that this might be a journey for some counter-parties, so expecting full compliance on day one may not be possible.

b. **Sustainability-linked finance:** Use KPIs that are robust, science-aligned and independently verifiable (e.g., absolute emissions, GHG intensity, renewable energy sourcing). Consider what will encourage positive behaviour rather than what penalties should be used for poor behaviour. Can your organisation help support climate change adaptation in any way?

c. **Force majeure:** Redefine clauses to exclude foreseeable climate events (which should now be mitigated, not excused).

d. **Material Adverse Change (MAC):** Clarify whether climate-related regulatory shifts or disclosure failures constitute a MAC.

e. **Indemnities:** Consider specific indemnities for breach of climate obligations or greenwashing liabilities.

3. **Post-contract**

a. **Ongoing monitoring:** Require periodic reporting on climate KPIs. Include audit rights. Update due diligence regularly.

b. **Internal governance:** Advise clients to update supervisory frameworks, compliance and procurement policies, whistleblower protections and staff training to integrate management and mitigation of climate change risks throughout their governance framework.

c. **Incentivisation:** Encourage integration of climate goals into executive remuneration and investment mandates.

d. **Disclosure alignment:** Support clients in developing internal processes to meet UK SDR, ISSB and other reporting frameworks.

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e. **Reputational audits:** Periodically review public statements, advertising and ESG disclosures for greenwashing/greenhushing risk.

Managing climate risk is not just a compliance exercise. It is a forward-looking act of stewardship. Lawyers have a key role to play - not by shifting risk onto others, but by designing frameworks that promote collaboration, resilience and accountability. In financial services, climate risk management is inseparable from the broader shift toward decarbonisation. Future-fit contracts will recognise this and lead the change.

Climate and nature impact investing terms

As a first step, why not consider Matteo's Clause - TCLP's model environmental terms and conditions that impact investors (financing private sector projects) can incorporate and adapt for its specific needs into its standard documents.

This clause will assist investors (and their financiers and intermediaries) in financing projects with positive environmental impact, in accordance with the Paris Agreement targets and the United Nations Sustainable Development Goals. This will in turn help the country of investment achieve its nationally determined contributions and transition to a low-carbon economy.

Use this toolkit flexibly: select the tools and drafting approaches most relevant to your transaction, adapt them to your client's context, and let us know how you're using it.

For now, we're only asking for your name and email through this feedback form so we can follow up with you later about your experience.

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