



Inquiry: Design of a Sustainable Financial System

CLIMATE CHANGE AND ITS IMPLICATIONS FOR THE GLOBAL FINANCIAL SYSTEM

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Financial reform & climate security



- Reforms to the US\$300trn financial system are a **key part of the transition** to zero carbon, resilient development
- These interventions are needed to **complement** resource pricing, environmental regulation and public finance
- Policy makers can **make a difference** on risk, capital mobilisation, market transparency and financial culture
- New opportunities for **international financial cooperation** beyond the UNFCCC (eg the Financial Stability Board)

“It is essential that the financial system as a whole takes climate risk into account, anticipates ambitious targets and integrates this into investment decisions.”

Laurent Fabius, Foreign Minister, France



Inquiry's aim and approach

“Advance policy options that would deliver a step change in the financial system’s effectiveness in mobilising capital towards a green and inclusive economy”

**A 2 year mandate,
reporting in October 2015**

WHY should rules governing the financial system be used in pursuit of green & inclusive outcomes ?

WHAT rules governing the financial system have been, and might be deployed as effective instruments?

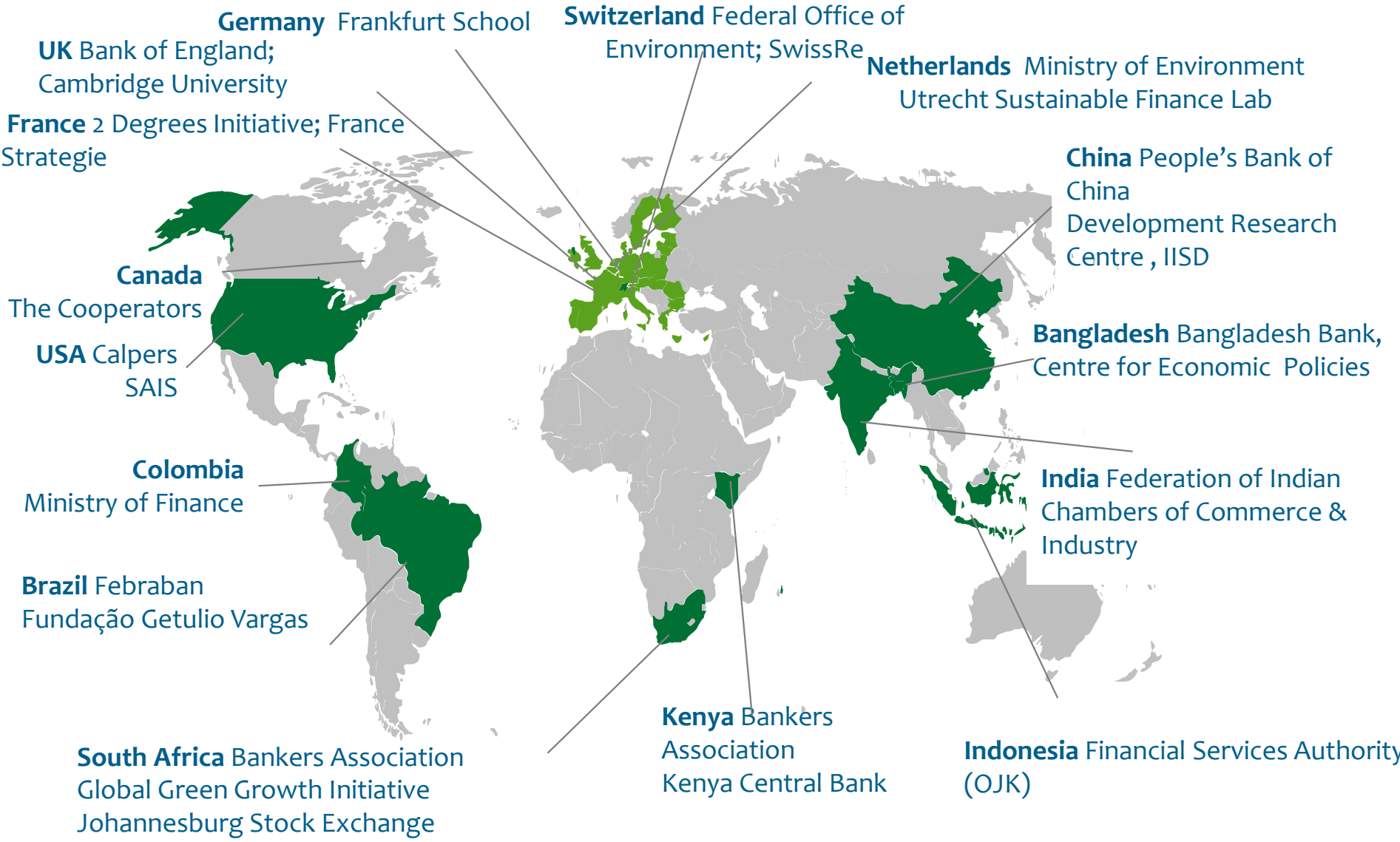
HOW rules can be deployed given the complexities & competitiveness concerns of financial actors and nations ?

“Financial regulators need to lead. Sooner rather than later, they must address the systemic risk associated with carbon-intensive activities in their economies.”

Jim Kim, President, World Bank

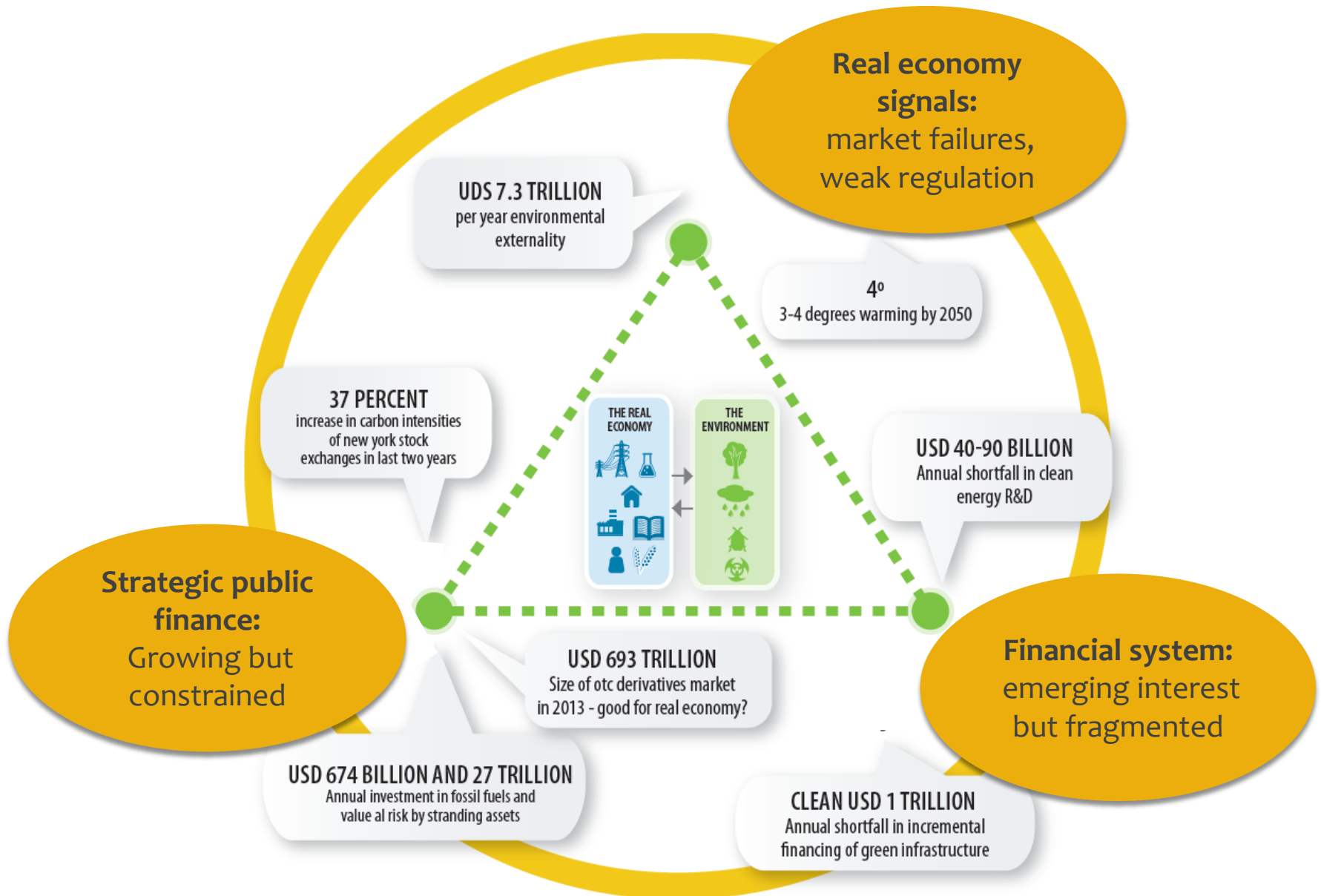
Inquiry: partnering for change

Includes formal and informal partnerships



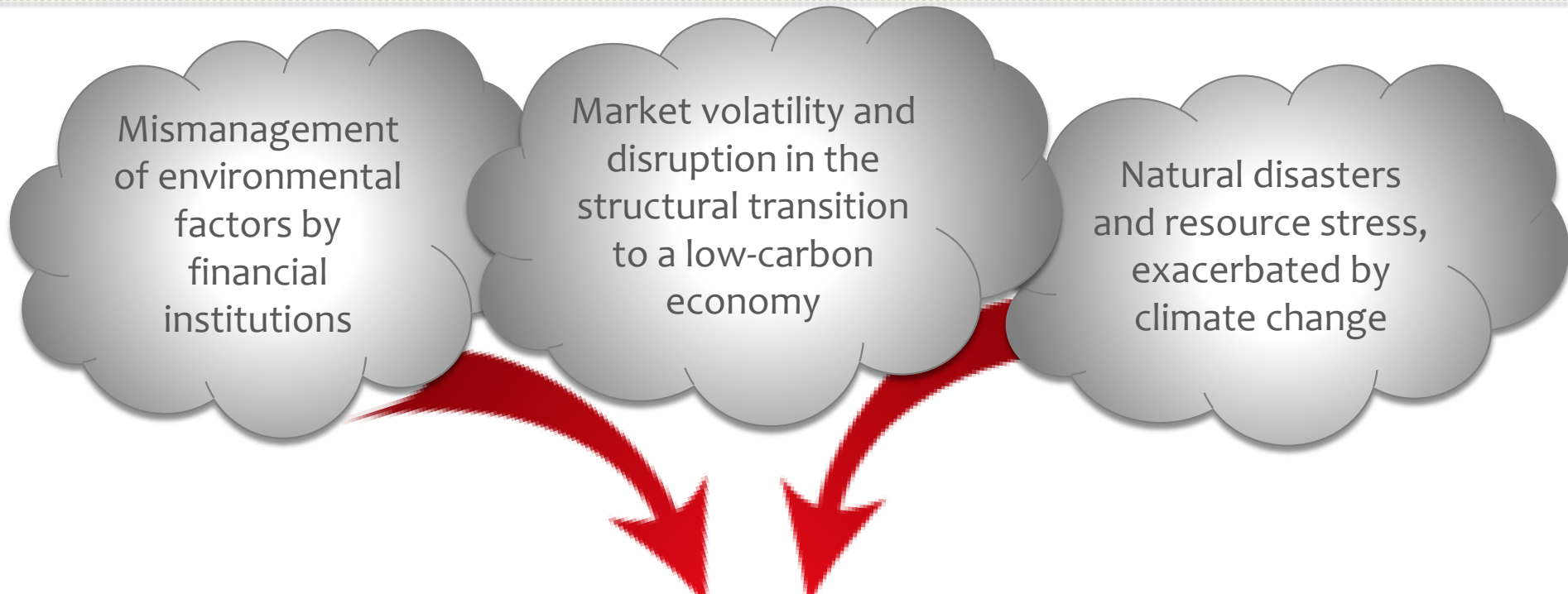
Internationally working with IFC, OECD, PRI, WWF

Mobilising finance: the triple challenge

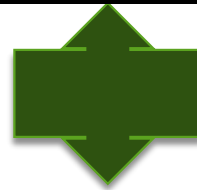




Environment as a Systemic Risk



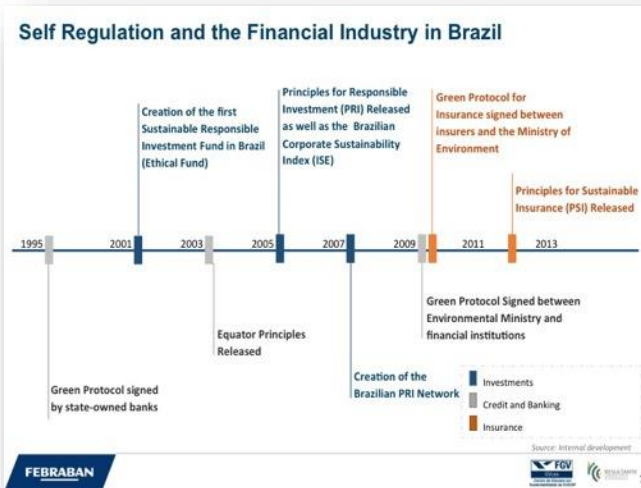
Do the rules governing the financial system enable or disable an orderly response to these challenges?



“By failing to address systemic environmental risks, Basel III is arguably overlooking an important source of risk to the financial system” Prof. Kern Alexander, Zurich



Brazil: first mover on sustainability



Capital Adequacy: In 2011, Brazil's Central Bank (BACEN) requested banks to monitor environmental losses as part of the Internal Review for Capital Adequacy (ICAAP).

Sustainability Risk: In 2014, BACEN introduced new requirements for banks to manage socio-environmental factors as part of core risk system to improve governance and strengthen soundness.

Implementation: Focus on relationship with legal liability, critical data required for enhanced disclosure



“Sustainability is a positive asset for financial and monetary stability”
Aloisio Tupinamba, Chief of Staff, Financial Regulation, Central Bank of Brazil



China: building a green financial system



Green Credit Guidelines: The CBRC's Green Credit Guidelines assess the entire balance sheet of licensed entities.

Green Financial System: The People's Bank of China has just completed with the Inquiry an in-depth analysis of measures required to channel capital from high-pollution, high-resource. Focus on market modernisation: rating, liability, disclosure, securitisation

Environmental stress test: Pilot assessment of impact of tightening pollution standards on bank balance sheets

Green credit criteria taking shape

Updated: 2012-05-16 17:00

By Zheng Yanpeng (chinadaily.com.cn)

CHINADAILY.com.cn

“Greening a country’s financial system is not an “additional” performance requirement but concerns the efficiency and effectiveness of the whole system”

Development Research Council of the State Council, China



UK: climate, carbon and stability



theguardian

'Carbon bubble' poses serious threat to UK economy, MPs warn

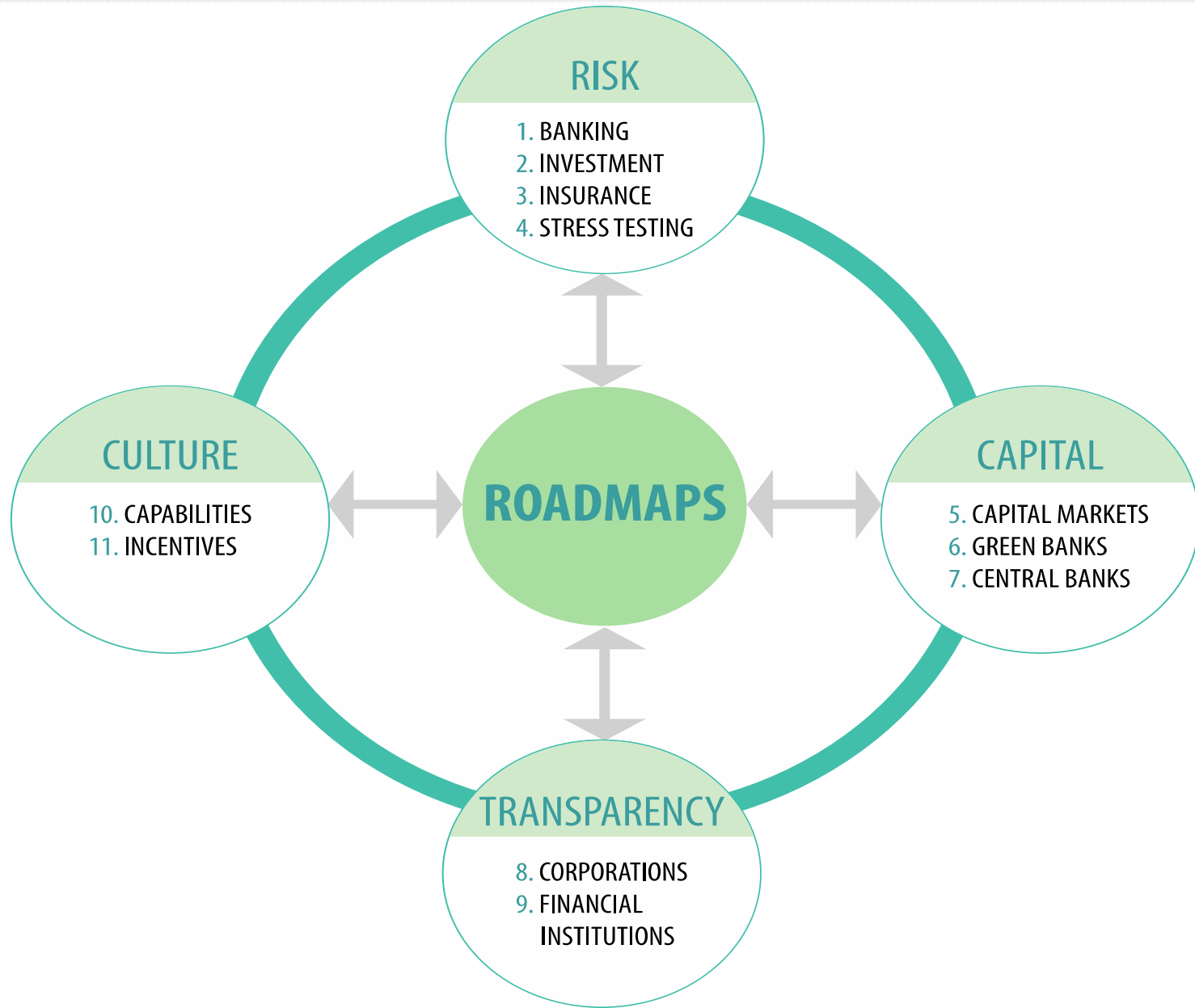
Prudential Regulation: The PRA is examining the impact of climate on safety and soundness of insurance companies: report July 2015

Financial Stability: The Financial Policy Committee expects the risks to financial stability to be beyond its 'typical policy horizon'

Research: The Bank has identified climate change as one of the five fundamental changes: impacts, transition & tools

"The central bank time horizon is relatively short - 1.5-2 years – but the real challenges to prosperity and economic resilience from climate change will manifest well beyond this. We face a 'tragedy of horizon'." **Mark Carney, Governor, Bank of England**

Policy options to align the system





- ⊙ **Banking** – risk management and prudential lending (‘green credit’)
- ⊙ **Investment** – management of long term climate factors as part of core risk, fiduciary duty
- ⊙ **Insurance** – integrate into for inclusion, solvency, underwriting and investment
- ⊙ **Stress Testing** – across financial sectors and markets

“In a plausible worst case for climate damage, the value at risk in 2030 may be equivalent to a permanent reduction of between 5% and 20% in portfolio value.”

Howard Covington & Raj Thamotheram

Enabling an orderly re-allocation of capital



**Green
Investment
Bank**



- ⊙ **Capital Markets** – scale up green bond markets through standards, incentives, regulatory refinement, indices,
- ⊙ **Green Banks** – crowd in private capital where development banks do not exist
- ⊙ **Central banks** – priority lending criteria, using refinancing and monetary policy operations

“Central banks can play a key role in delivering sustainable development. For the Bangladesh Bank, green finance is a strategic tool to support investment in clean energy.” **Atiur Rahman, Governor, Bangladesh Bank**

Make transparency systemic



- ① **Corporations** – ensure corporations and issuers of securities publicly report on critical sustainability and climate factors
- ① **Financial institutions** – enhance disclosure by financial institutions on allocations to green assets, climate performance and exposure to risk

“There are almost 400 different provisions that directly or indirectly affect reporting of sustainability information... A model convention could encourage reciprocity between reporting regimes .” **Carbon Standards Disclosure Board**



- ⊙ **Stability:** Identifying the tools to manage the system-wide risks of climate change (Financial Stability Board)
- ⊙ **Infrastructure:** Aligning strategies for long-term finance with zero carbon and resilience (G20)
- ⊙ **Banking:** Incorporating sustainability factors into the Basel Accords: capital requirements, supervisory review and market discipline (BIS)
- ⊙ **Insurance:** Developing guidance on how to apply Insurance Core Principles to the challenge of climate change (IAIS)
- ⊙ **Pensions:** Sharing best practice on the links between climate change and investor governance (IOPS)

“The short sightedness of financial regulation is leading to a misallocation of savings which is making the issue of climate more difficult to solve” **Henri de Castries, CEO,**



A 2 degree financial system

- Steering innovation for climate security
- Making decisions within the carbon budget
- Delivering access to green finance
- Closing the protection gap
- Improving full cost system efficiency



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