WWF BRIEF INT 2017

GREEN FINANCE WWF ASKS TO G20

Hot House, 14 February 2017

Introduction

WWF welcomes the decision by the German presidency to continue addressing the significance of environmental risks for international financial market stability by furthering the activities of the Green Finance Study Group (GFSG) established under the Chinese Presidency in 2016. The G20 can play a significant role in initiating better international monitoring and regulation of financial markets. Standards, particularly as they relate to **addressing environmental risk, are one key lever to achieve this**.

WWF strongly welcomed the G20 leaders' commitment made in Hangzhou, 2016, to **scale up green finance** to support environmentally sustainable growth globally. WWF now calls on the G20 to translate this **important political signal** into concrete actions towards the transformation of the global financial system, to **increase policy coherence** by further integrating sustainable finance aspects into other G20 work streams, and to broaden the scope of issues covered by the GFSG.

WWF recommendations to the G20 on Green Finance

WWF calls on the G20 to:

- Elevate the GFSG to a **G20 Working Group** with a **permanent focus on environmental risks** and increase the level of **transparency and stakeholder participation** of the working group;
- Set up a **platform** to facilitate **research and knowledge exchange** on the links between **environmental risk and financial stability** involving regulators, researchers and civil society;
- Ensure that **environmental risks, including climate risks, and social risks** are adequately **and consistently identified, assessed, measured, managed, and disclosed**. To achieve this
    - Agree to implement the recommendations of the Financial Stability Board Task Force on Climate-Related Financial Disclosure (FSB TCFD) and facilitate standardized climate risk reporting amongst G20 member countries;
    - Agree to include quantitative parameters of financial risk resulting from environmental risks in the regulation of banks, insurance companies, and securities markets, particularly harmonised listing rules;

- Agree to evaluate existing practice and recommend frameworks to conduct "**environmental risk assessments**";
- Agree on a **common framework and minimum performance standards for ESG integration and risk management** in the investment policies of G20 government-linked pension funds and sovereign wealth funds;

- Agree to establish **a monitoring tool to review the degree of alignment of capital markets with the Paris Agreement** (Art. 2.1.c); and
- Pursue the integration of ecosystem assessment and cumulative impact assessment in **infrastructure projects** in order to find technical solutions with minimum negative impacts;
- **Improve inter-ministerial cooperation** nationally to set **clear strategic policy goals** for scaling up Green Finance globally and **inform about progress** in reaching them**.**

Background

There is increasing recognition that climate change, resource scarcity, deforestation, biodiversity loss, land degradation, and water quality and availability already represent significant risks to the global economic system and will do so increasingly looking forward. These risks are substantial obstacles to achieving G20's priority to "*safeguard strong, sustainable, balanced and inclusive growth*."[1]

The G20 can build on lessons learned and best practices, as more and more governments enact policies that incorporate sustainability considerations into their financial systems to reflect the interrelationship between environmental risks and financial system stability.

WWF commends the GFSG for the focus on two research subjects in particular: environmental risk analysis and environmental data, such as availability, access and relevance.

Links between environmental risks and financial stability

Recent academic research provides evidence about the links and materiality of environmental risks to financial risks. WWF and its project partner ecos[2] recently commissioned three academic studies that analysed systemically relevant risks from several angles: financial-sector interlinkages (also called network effects)[3]; natural catastrophe effects on the real economy[4]; and infrastructure bond yield spreads[5]. Each study shows, although wide-ranging in considerations and methodology, clear links between environmental risk and financial risk. The main findings are that:

- climate-policy risk poses a threat to the solvency of the banking sector, via network effects[6];
- there is a negative correlation between climate-change related natural catastrophes and financial market resilience; and,
- high-emission infrastructure pays a higher risk premium.

[1] Several G20 Leaders' Declarations, e.g. Los Cabos 2012
[2] www.ecos.ch
[3] Battiston, Stefano and Mandel, Antoine and Monasterolo, Irene and Schuetze, Franziska and Visentin, Gabriele. A Climate Stress-Test of the EU Financial System. 2016. Available at SSRN 2726076.
[4] Sebastian von Dahlen. The missing link? A contribution to assessing the correlation between climate-change related catastrophes and financial market resilience. Unpublished.
[5] Daniil Kiose and Steve Keen, Kingston University. Understanding the impact of environmental and social risk

WWF believes the G20 and partner institutions should undertake more work to fill the knowledge gap in linking environmental risk and financial stability, for example via the establishment of a knowledge platform. Work areas should include: analysing risk management processes, risk quantification needs, and models; increased importance and consideration to widely, comparably and consistently applied scenario analysis as a risk mitigation tool; and regulations. This work naturally follows from lessons learned in the ongoing G20/TCFD work on climate and carbon risks, and can be expanded to other forms of environmental risks such as water risks and should involve regulators, academics, and civil society. Further risk aspects resulting from resource scarcity, deforestation, biodiversity loss and land degradation require to be analysed and evaluated urgently to be brought to a similar level of insights as water and carbon related risks.

Climate and carbon risks assessments

WWF **welcomes the work of the FSB TCFD on climate and carbon risks** and urges the TCFD to strengthen its recommendations[7].

To achieve the SDGs and the Paris Agreement climate targets, **carbon stress testing** is an important instrument that needs to be better understood. Carbon stress testing means analysing the impact on the level of risk in a portfolio that arises from carbon related regulation, specifically with respect to scenarios aligned with science and political agreements like the Paris Agreement. Such analysis should be conducted across entire portfolios and across sectors rather than just on exposure to the energy sector.

The G20 should mandate an **analysis of the existing practices of central banks** with respect to carbon stress tests and applied scenarios therein, evaluate the results and experience by March 2017, and agree on **common elements of such stress tests** (including models, scenarios, data and other tools). Standardised **carbon stress tests should then be agreed and introduced** across the G20, based on standardized methodology and standardized scenarios. This is the only way to provide adequate and consistent climate-related information to the market.

More in detail, the G20 should also agree on the **central elements of 1,5° C/2°C/business-as-usual scenarios** as a **common baseline** in order to eliminate the current ambiguity on the parameters and assumptions on applied scenarios when investors run stress tests or carbon risk assessments.