<u>Waterproofing the economy: the central bank and supervisors perspective</u>

Conference “Advancing TCFD guidance on physical climate risk & opportunities”

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Speech:

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<u>Introduction</u>

- Dear mister Tanaka, thank you for this kind introduction and, ladies and gentlemen, it is a privilege for me to speak here today.

- As one of the representatives of the central bank and supervisory community I am delighted about this conference for at least two reasons.

- First, because it aims to take the next steps needed to mainstream climate risks into our financial system. A task that is not easy, but also very necessary to ensure both future financial stability and the sustainability of our planet.

- And second, because it focuses on physical risk (flood, drought, hurricanes etc.), which up until now has received much fewer attention than its counterpart, transition risk.

- To me, this is as if my favorite soccer team is trying to win the game by focusing solely on scoring goals. Important, of course, but winning the game requires that you also focus on your defense. Similarly, we should focus on transition risks, but we cannot afford to neglect the physical ones either.
- The current work by the EBRD and the Global Center (of Excellence in Climate Adaptation) hence fills an important space.

- Of course, I somewhat hope that we will mainly encounter transition risks. Which means that we then avoid the worst consequences of climate change. But even with the strongest mitigation efforts possible we *will* experience severe changes in weather patterns and sea level rise in the decades ahead.

- Like you heard from Roald Lappere, this is a trend that is not least important to the Dutch – as large parts of the Netherlands are below sea-level and vulnerable to flooding. (Some areas are at 7 meters below sea-level).

- Hence I am very happy to see you all here, so we can move to "waterproof" our economies.

- In the remainder of my talk I want to share some of the considerations that we have as a central bank and financial supervisor, and I will also touch on the recent launch of the Central Banks and Supervisors Network on Greening the Financial System.

<u>What has happened so far?</u>

- Let me start by saying that DNB and other central banks have already taken quite some steps in recent years.

- To raise awareness, we have published our report "Waterproof", which sets out the relevant risks for Dutch financial institutions and has initiated discussions within our financial institutions.

- For example, we found that in the Netherlands, new legislation for energy efficiency in buildings can have a substantial impact on the real estate portfolios of our financial institutions. And related to physical risks, we raised the awareness about unlikely but severe flood scenarios in the Netherlands.

- Also, to further identify what the risks are and what the effect could be on the financial sector, we conducted a stress test on weather related risks for our general insurers and we are currently developing a stress test on transition risks, exploring four future policy and technology scenarios.

- Of course, within the central bank and supervisory community we are not the only ones acting on climate change. Similar steps have been taken by other central banks and supervisors, and we see that awareness about climate change and associated risks is rapidly growing within the central bank community.

- This is also clearly supported by the launch of the Network of Central Banks and Supervisors on Greening the Financial system (NGFS) in Paris in December 2017.

- The Network's purpose is to help strengthening the global response required to meet the goals of the Paris agreement. It aims enhance the role of the financial system to <u>manage risks</u> and to <u>mobilize capital</u> for green and low-carbon investments (there are three work-streams in total, two on risks and one on mainstreaming green finance).

- 15 authorities are now taking part with a global reach: as far as China, Singapore and Mexico and as close to home as the United Kingdom, France and Germany.

- And earlier this month, the European Central Bank also joined as a member.

<u>Considerations for central banks and supervisors</u>

- Of course, central banks and supervisors have their specific mandates. Chief amongst those are price stability, financial stability, and the solidity of our financial institutions.

- Climate change poses new challenges from these perspectives as, traditionally, many of the financial sectors' management tools are backwards looking. It is all too common look at historical patterns to make educated guesses about future risks.

- With climate change this is different. We need to now shift our horizons for risk management more towards the future, and incorporate changes in risks that we may reasonably expect.

- I would, for example, not like our pension funds to unknowingly invest in real estate that may literally be underwater in a few decades time.

- In our last year's report we therefore made a strong call to the financial sector to improve their forward looking risk management tools, such as scenario analysis and stress testing. Tools that are also emphasized by the FSB Taskforce on Climate-related Financial Disclosures (TCFD).

- Steps have already been taken in that respect: I know that the EBRD is one of the organizations that already early on started to include climate risk assessments and adaptation measures in their investment operations.

- And I know some of our Dutch banks and asset managers are making first steps towards integration of climate related risks in their investment and credit decisions. These are however mostly focused on transition risks so far.

- To perform proper forward looking analysis and for example include the effects of sea level rise, investors and loan providers do need to know to which risks they are exposed – so they can then make informed decisions.

- And there lies the challenge, as our financial institutions tell us they do not have all the tools and information yet.

- Here, economy-wide disclosure is one of the key missing elements. This is because it enables our financial institutions, like banks and asset managers, to consider climate risks on a firm-level basis to improve their loan and investment decisions.

- Together with other measures (like the creation of a common taxonomy by the European Commission), disclosure should lead to climate risk obtaining it's fair market price, and thereby also spur cost-effective adaptation measures.

- Hence I think disclosure is a very logical step forward, and certainly the first step to make – before we for example consider making more quantitative requirements in our supervision.

- This also fits well with our current supervisory approach with respect to climate risks, which targets pillar II (supervisory review) and pillar III (reporting and disclosures; market discipline).

Closing

- I will wrap up.

- To achieve true sustainable capital allocation we need get all the relevant information across the entire investment chain.

- Climate risks need to be fully integrated in capital allocation decisions, and for this our financial institutions need the proper information.

- To that end I am highly supportive of all initiatives, like today's, that improve disclosure of climate risk information to those that make allocative decisions.

- This to ensure not only future financial stability, but at the same time also the sustainable prosperity of our planet.

- So that, in terms of physical risks, our economies and financial sectors become ever more "waterproof".