30 July 2019

Mr. Frank Elderson
Member of the Governing Board
De Nederlandsche Bank
Chairman, NGFS

c/o Morgan Després
NGFS Secretariat
Banque de France

Dear Chairman Elderson,

The IIF Sustainable Finance Working Group (SFWG) welcomes the NGFS report *A call for action: Climate change as a source of financial risk* as a landmark document in the effort to ensure the financial sector is resilient to climate-related risks and to support the transition to a green and low-carbon economy. The rapid growth of the NGFS in such a short period of time demonstrates the urgency of the issues and the strong commitment of central banks and supervisors. The coverage of the NGFS in terms of percentage of global greenhouse gas emissions, global GDP, and supervisors of systemically important banks and insurers clearly marks the NGFS as the global body to discuss these issues. The SFWG, chaired by Daniel Klier of HSBC, represents the IIF's equally global membership and is pleased to be a private sector counterpart of the NGFS. This letter represents a first set of reactions to the NGFS report with a focus on the specific recommendations and planned deliverables of the NGFS. The SFWG would be pleased to discuss these further with the NGFS leadership and workstreams, as appropriate.

General Comments

As noted in its letter to the NGFS last year, the IIF Sustainable Finance Working Group (SFWG) shares the view that climate-related risks are a source of financial risk and thus within scope of central bank and financial supervisory mandates. That point seems to have gained further acceptance since the initial NGFS report in October 2018 as clearly demonstrated by the growth in the NGFS membership. It is still worth repeating, however, as there are notable gaps in the NGFS membership and some central banks and supervisory agencies still seem reticent to fully commit to the idea. The SFWG encourages and will seek to support NGFS efforts to ensure that all major financial centers are represented in its work through membership of central banks and supervisors in their jurisdictions. More comprehensive representation will help ensure alignment of approaches and prevent fragmentation of efforts. This is particularly important as many of the issues being addressed are global in nature and require globally coordinated solutions.

The SFWG also notes that discussions in the financial sector need to be part of broader deliberations among policymakers about how to ensure economies are on a pathway to meet key targets such as those established by the Paris Agreement and Sustainable Development Goals. The private financial sector is committed to doing its part to help clients make the necessary adjustments and to finance transitions. Clear policy signals and incentives will accelerate those efforts and the SFWG encourages the NGFS to continue and expand engagement with the wider set of policymaking stakeholders, both within the financial sector (e.g. FSB, Basel Committee, IOSCO, and IAIS) and more broadly (e.g. G20 Finance Ministers, European Commission). In that regard the SFWG welcomes the recent statement by the Coalition of Financial Ministers for Climate Action in the form of the Helsinki Principles and encourages a dialogue where appropriate between the NGFS secretariat and the Helsinki Principles secretariat at the World Bank on policies (e.g. carbon taxes) that would facilitate appropriate pricing of climate change risks and help address current market failures in this regard.

The SFWG is committed to working with the NGFS in a collaborative manner to develop the necessary new analytical and methodological approaches to better understand emerging risks related to environmental, social and governance factors. To help structure this engagement, we propose regular meetings or calls between SFWG leadership and the NGFS secretariat as well as subgroup leaders of the NGFS steering body to discuss current industry developments as well as potential next steps by central banks and supervisors. We would also be pleased to coordinate an annual or semi-annual meeting between IIF Board Members and senior NGFS officials and have proposed a first such gathering on October 17 alongside the IMF/World Bank Annual Meetings and the IIF's Annual Membership Meeting. The SFWG also encourages NGFS members to leverage both its secretariat and steering body for efficient and effective collection of data and other information. There are a number of individual central banks and supervisors undertaking survey and other data collection efforts at the same time and some of the efforts seem to overlap in content. SFWG members are pleased to see authorities' efforts to base their views on facts but do suggest that data collection results may be more effective and robust if such efforts are consolidated. Moreover, we believe that the IIF and its SFWG can provide the NGFS and its members with an efficient way to reach a broad set of firms quickly either for data collection or for more elaborate exercises such as system-wide scenario analyses. Pooling public and private sector resources in areas such as data collection and scenario analysis—and leveraging parallel efforts in the academic community—would accelerate the development of an essential body of knowledge. Towards that end, the SFWG has launched a series of workshops around disclosure/data, metrics and scenario analysis; the first two of these were held in Tokyo and Amsterdam in June.

Recommendation n°1— Integrating climate-related risks into financial stability monitoring and micro-supervision

The SFWG appreciates the commitment of the NGFS to integrate climate-related risks into core financial supervisory processes. Some supervisors, e.g. UK PRA, have already made statements in this regard, and we understand that others are considering following that lead. The SFWG has provided its views on the PRA approach and would urge other supervisors to consider these comments before embarking on their own efforts. More broadly, the SFWG believes that an aligned approach across jurisdictions is vital. In that regard, the NGFS commitment to develop a "handbook" is very useful to help avoid inconsistencies. While recognizing that the NGFS does not wish to be a standard-setter it would still be useful to have a statement that outlines a range of potential supervisory practices and helps guide supervisors on which approaches may be most appropriate given the current state of industry practice and data availability. The SFWG will seek to provide industry input and would be pleased to review and provide feedback on the NGFS handbook as it develops.

The SFWG also appreciates the NGFS commitment to develop voluntary guidelines on scenario-based risk analysis including potentially four scenarios that have "clear plausible qualitative narrative" but also are "data driven and provide quantitative parameters." A number of SFWG members have been researching different methodologies and types of scenarios to guide their own risk analysis. The SFWG itself has added a new Climate/ESG Economics subgroup to consider scenarios around the impact of climate change (and broader ESG factors) on the global economy and financial stability. This subgroup plans to produce a report in H2 2019 that discusses potential transmission mechanisms between climate drivers and corporate financial performance that may allow for quantification of impacts of given climate scenarios. The SFWG would be pleased to collaborate with NGFS efforts in train—particularly since having a shared set of reference scenarios would help ensure both supervisors and the industry are aligned on basic assumptions or starting points from which risk analyses are produced.

Given the above and the data challenges commented on below, the SFWG is cautious about mandatory scenario analyses and stress tests at least in the form that the industry knows today in the prudential framework. Scenario analyses as currently conducted by firms are useful for understanding potential risk pathways and exposures, but the quantification is more directional than precise particularly given the data challenges and the time frames involved. The SFWG appreciates the efforts being made by individual supervisors (e.g. De Nederlandsche Bank, Bank of England) to undertake system-wide exercises in their jurisdictions. The SFWG would in due course be pleased to work with the NGFS on collaborative cross-jurisdictional exercises that can help further understanding on the insights from and limitations of current methodologies and practices. It may prove most efficient to combine resources both among the supervisory community and the private sector to allow for combined learning by doing and focus efforts. The SFWG would be pleased to discuss modalities for such exercises if this would be of interest to the NGFS.

The SFWG notes the NGFS comments on potential inclusion of climate risk in the prudential framework and understands from the 17 April NGFS conference that the supervisory focus is more on "brown factors" than "green factors". The SFWG shares the NGFS view that the capital regime should remain risk-based and therefore any adjustments should be guided by quantifiable and demonstrated risk differentials. However, we caution that the availability of data is limited and that historical data may not even be representative of future risks given uncertainties around physical and transition risk pathways. Thus, the SFWG would suggest prioritizing efforts and believes that more benefit may be gained in the first instance from disclosure efforts and scenario analyses as well as active engagement with supervisors through Pillar 2 dialogues rather than political debates about capital requirement adjustments.

Recommendation n°2— Integrating sustainability factors into own portfolio management

The SFWG welcomes the commitment by NGFS members to integrate sustainability factors into their own portfolio management and commit to initiatives such as the PRI, as recently done by the HKMA. Given the rapid pace of development and the still-emerging understanding of sustainable investing, it is critical that central banks learn by doing. The SFWG asset owner, asset management and insurer members would be pleased to share knowledge and experience with NGFS members on emerging best practices in this field. The IIF is working on a project with reserve managers focused on ESG integration including asset allocation and benchmarking, external mandates, and engagement activities. The SFWG would be pleased to share the results of this effort once completed.

Additionally, the SFWG encourages NGFS members to explore the links between climate change and monetary policy. This is both because of the potential for carbon-bias in central banking operations due to the fact that capital intensive companies are often more carbon intensive (see CEPR paper, “Greening monetary policy”) as well as the potential role that central banks can play in scaling green finance via monetary policy as shown by the People's Bank of China among others. Understanding the links and ensuring alignment between central bank operations (e.g. asset purchases, collateral frameworks) and the broader goal of inclusive and sustainable growth is essential. The SFWG encourages the NGFS to continue work on its research program including reaching out to a range of partners through networks such as INSPIRE.

Recommendation n°3— Bridging the data gap

As rightly noted by the NGFS, data is a key challenge and critical precondition for conducting sound Climate Risk Assessment (CRA). Firms and supervisors have a shared interest in having robust, transparent, and shared data sets on which individual analyses can be performed. Data is a public good and there is support among the SFWG for collaborative public-private efforts to fill data gaps where possible. The SFWG also agrees that while the need for data is often cited there is frequently not enough specificity about what is lacking in order to act. There is a need to define more clearly the types of data that are needed and for what purpose they are required. Thus, the SFWG appreciates the offer of the NGFS to "initiate work with interested parties on setting out a detailed list of currently lacking data items…to allow providers to mine relevant data and progressively bridge the gaps." The SFWG is currently discussing among its members and will come back to the NGFS with more specific ideas on how it may collaborate in the effort to more clearly document data gaps and the requirements that need to be met to support CRA and associated scenario analyses and stress tests. In this context, the aforementioned series of SFWG workshops on disclosure/data related issues are expected to provide useful input.

Recommendation n°4— Building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing

The SFWG appreciates the investments being made by NGFS members in their in-house capacity as well as in collaboration with wider stakeholders to improve their understanding of how climate-related factors translate into financial risks and opportunities. The wide range of members in both the SFWG and NGFS are starting from different points and need to develop their understanding not only of the impact of increasingly severe weather events but also climate-related physical and transition risks more broadly as they are distinct topics. This takes time and commitment of resources to develop the necessary skills and knowledge and cannot be done overnight. It is an investment of resources that both firms and public institutions must make as we jointly seek to develop the tools and methodologies needed to identify, quantify, and mitigate climate risks in the financial system. This is a shared goal of both the public and private sector and the SFWG members are pleased to support the public sector efforts. As noted above, the SFWG has started a discussion on climate economics among its members who are macro- and microeconomic specialists and will be pleased to share the learnings from this effort with the NGFS in the future.

Recommendation n°5— Achieving robust and internationally consistent climate- and environment-related disclosure

SFWG members share the emphasis of the NGFS on a robust climate and environmental disclosure framework. The standards established by the TCFD are very helpful in that regard and SFWG members are committed to working towards effective implementation over a multi-year pathway. The IIF will shortly be publishing a report with an initial stocktake on financial sector implementation of the TCFD recommendations, which will seek to identify leading practices in TCFD disclosure. The SFWG will share that with the NGFS as well as the TCFD and would be happy to discuss the initial findings. The SFWG appreciates that some NGFS members such as the Banque de France are leading by example and disclosing their own climate-related financial risks along the TCFD recommendations. The SFWG encourages other NGFS members to consider doing the same to gain practical experience.

The SFWG notes that sustainability disclosure is addressed by multiple efforts currently including in several different forms. These include regulatory requirements such as the EU Non-Financial Disclosure Directive or Article 173 of the French Energy Transition Law; comply or explain approaches, including the EU Sustainable Finance taxonomy, as well as those implemented by stock exchanges or governance codes; and voluntary efforts such as GRI, SASB, the Integrated Reporting Framework and the TCFD itself. In addition, supervisors are considering additional approaches through prudential requirements (e.g. Pillar 3). Notwithstanding the benefits of competition in the marketplace, SFWG members do see a need for consolidation in the number of reporting standards and initiatives and welcomes the work of the Corporate Reporting Dialogue to try to achieve alignment among some of the major standards.

As noted in a recent letter to IOSCO, the IIF encourages further efforts by all standard-setters and national authorities to work towards aligned approaches that help avoid further fragmentation and overlapping requirements. Thus, the SFWG supports the NGFS call on supervisors to align expectations on the type of information to be disclosed. When it comes to climate-related financial risk specifically, the TCFD should be recognized as the standard and it should be possible for financial firms (and corporates) to meet their disclosure obligations by way of fulfilling the TCFD recommendations.

Recommendation n°6— Supporting the development of a taxonomy of economic activities

The SFWG appreciates the NGFS comments on the Taxonomy. This topic has been the source of much discussion particularly in the context of the European Commission Sustainable Finance Action Plan. The SFWG welcomes the recent publication of the Technical report on EU Taxonomy from the Commission and its Technical Expert Group with additional detail on how the European version of a taxonomy may be structured. This will allow for further consideration of the approach being proposed and its potential use cases within the market.

As noted in its letter sent to the EC Technical Expert Group, the SFWG favors a principles-based approach to the development of any taxonomy. This should include due consideration for what exists in the marketplace already (e.g. Green Bond and Loan Principles and other similar standards) as well as the need to support transitions rather than binary distinctions into "green" or "brown" activities. Any taxonomy efforts should result in a product that is implementable in the marketplace and works with industry dynamics. Thus, the SFWG does have some concern about a taxonomy that is based solely on a granular set of activities as that is not generally how financial services and products are constructed or provided in the marketplace.

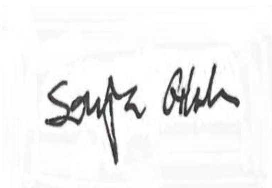
In general, the SFWG believes that competition among ideas and approaches is beneficial to all. Differences of views among analysts producing ratings or differences of views among firms assessing risks is part of how financial markets work and has historically been viewed as necessary to an effective private sector marketplace. Stakeholders would not expect financial firms to have a uniform view on company valuation or the riskiness of assets. Thus, it seems inconsistent to expect that sustainability ratings or methodologies all work in a single standard manner or produce a uniform result. The marketplace benefits from continued differences of views on what is sustainable as ideas compete with each other and spur further innovation and learning. There is no doubt a need to prevent greenwashing, but this can be addressed through appropriate disclosure and application of the current conduct norms around suitability, conflicts of interest, and fraud that have governed oversight of financial services through many cycles of innovation in the financial sector. The absence of a fixed taxonomy would not preclude data collection as evidenced by the continued publication of sustainable investing or green finance market growth — the green bond universe now stands at some $430 billion.

As shown by the rapid uptake of the IFC Operating Principles for Impact Management, a process-based standard may be more effective to set standards and guide behavior particularly in a complex value chain such as finance. This is a well-known and well-proven approach from regulation in other parts of the economy such as the food and agriculture sector where most regulatory standards are process-based rather than outcome-based. The SFWG encourages policymakers to consider the different approaches that are possible for sustainable finance regulation before hardwiring an approach that may not be well aligned with how the financial sector works in practice.

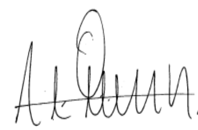
Given the need for scaling of green finance and leveraging private sector capital to address key climate and sustainable development challenges it would be unfortunate to impose a compliance-based exercise on top of sustainable finance products and services. Innovation and growth may be better served by a principles-based and process oriented regulatory approach. While recognizing that the NGFS is not actively working on a Taxonomy itself, the SFWG would be pleased to discuss the Taxonomy concept further with NGFS members particularly given their influence in the broader public policy discussions on the topic. The SFWG will also be submitting a response to the European Commission's consultation on the Technical Report on EU Taxonomy, which will build on the principles set out in the letter submitted earlier this year to the TEG.

The IIF hopes that the comments above will contribute to setting realistic expectations that help the industry tackle climate-related risks and help the official sector to create a supportive policy and regulatory environment. We would appreciate the opportunity to discuss these matters further with you and invite you to contact us should you have questions or comments.

Sincerely,



Sonja Gibbs
Managing Director
Global Policy Initiatives



Andrés Portilla
Managing Director
Regulatory Affairs