Sustainability and climate risks

The role of the financial sector and the regulator

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Agenda

Structure of my talk today

DNB and sustainability

Understanding climate risks

Next steps

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DNB and sustainability

The Dutch Central Bank works to achieve financial stability and is incorporating sustainability as part of her core tasks

DNB

- The Dutch Central Bank (DNB) is an independent **central bank**, **supervisor** for banks, insurers and pension funds and **resolution authority**.

Mission

- DNB works to achieve **financial stability** and thereby contributes to **sustainable prosperity**.

Risks

- From the supervisory perspective, DNB focuses on **sustainability risks** and in particular those risks related to climate change and the energy transition.

DNB and sustainability

The Dutch Central Bank embeds sustainability in her core tasks, with a focus on sustainable finance and climate related risks

Sustainable finance

- **Report** on sustainable investment in the Dutch pension sector
- Host of the **National Platform for Sustainable Finance**
- Founding member of the **Network for Greening the Financial System (NGFS)**
- Member of the **Sustainable Insurance Forum (SIF)**

DNB works to achieve financial stability and thereby contributes to **sustainable prosperity**.

Climate risks

- **Report** on climate-related financial risks in the Dutch financial sector ("Waterproof")
- Development and application of **climate related stress tests**
- Embed climate-related risks more firmly into our **supervisory approach**

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DNB currently chairs the Network for Greening the Financial System to stimulate cooperation between central banks and supervisors

- Network of 18 CBs/supervisors (including ECB/SSM) and 5 observers
- Exchange experiences and share best practices on climate and environments risks
- Key milestones:
  - Stocktaking exercise in 2018
  - Communication on progress at the IMF-WB annual meeting in October 2018
  - 1st NGFS progress report to be published in Q2-2019

Understanding climate risks

In our report ‘Waterproof’ we identify four major themes that are relevant to the Dutch financial sector

Physical risks	Transition risks
Insurers (P&C)	CO2-intensive assets
Flood risk	Green finance

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Dutch insurers will face changing weather related risks

Climate related claims

More frequent and severe hail and thunder in summer

The intensity of extreme rainfall will increase in the summer; in the winter there will be more rain/snow

No big changes in windspeed, although there is uncertainty about e.g. clustering of storms

The sealevel will rise, in the KNMI scenario's with a maximum of 100cm in 2100 but latest research shows quicker sealevel rise is possible

Impact on Dutch general insurers

1. **Higher premiums, possibly shock-induced**
2. **More uncertainty in catastrophe models (extra layer of complexity in risk modelling)**

DNB has performed a stress test for P&C insurers which included several climate related scenarios

Hurricane strength storm (1-in-250 year)

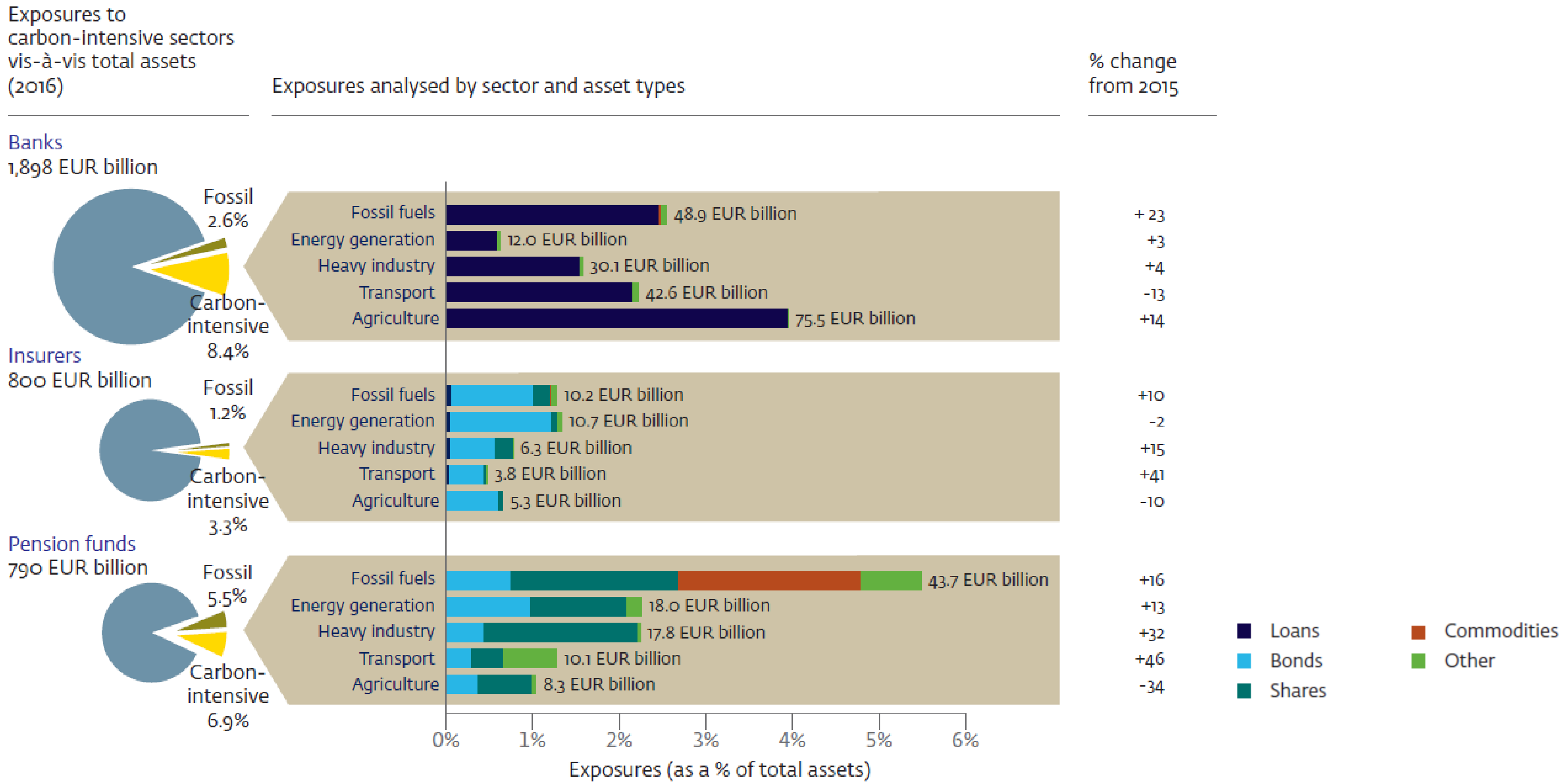
Three major storms in one year

Extreme local hailstorm

Leads to an S2-ratio below 100% for about a quarter of P&C insurers under investigation

Understanding climate risks

The Dutch financial sector has substantial exposure to carbon intensive sectors, which has slightly increased from ‘15 to ‘16



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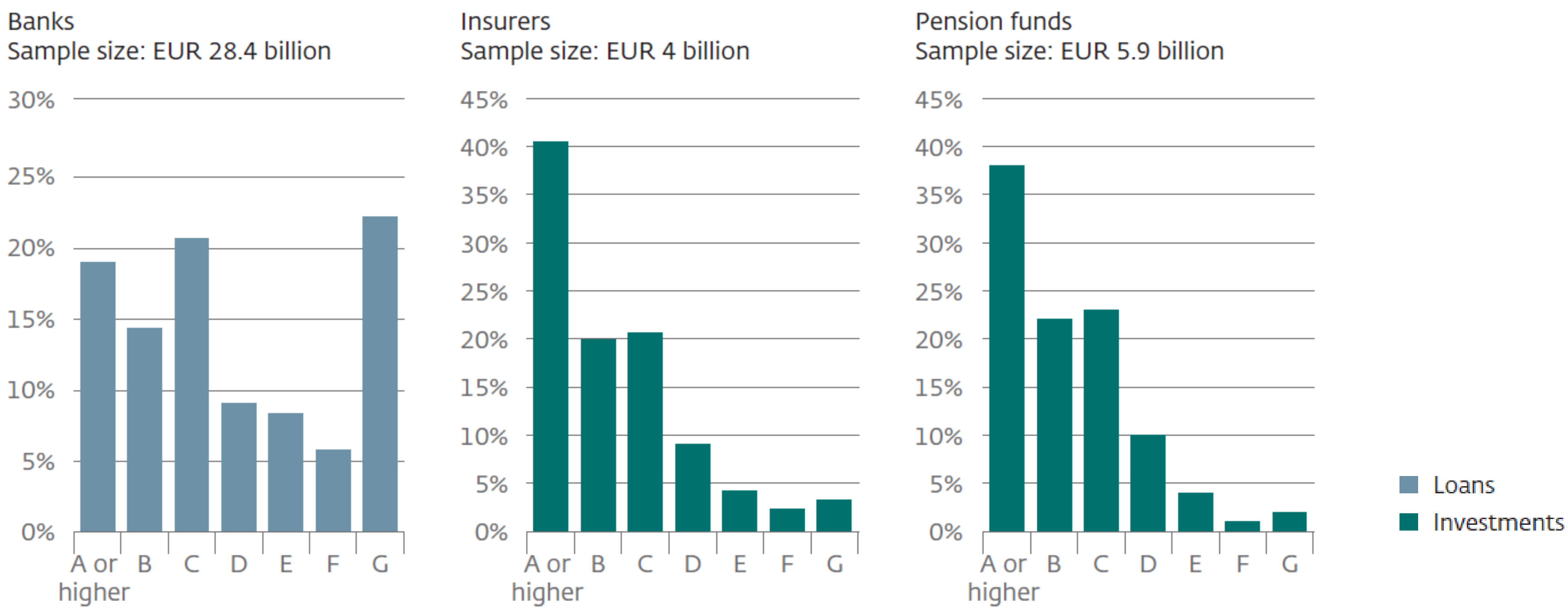
Sector specific legislation is taking shape, such as energy efficiency requirements for real estate

Label distribution of commercial real estate loans and investments in the Netherlands



As a supervisor DNB would like to see that climate risks are adequately identified, priced and managed by the financial sector

Financial institutions

- **Financial institutions must identify the climate risks that are relevant to them and take these into account**
  - Implement more forward looking elements in risk management
  - Insurers must pay more attention to potential climate change trends in their catastrophe models

Policy makers

- **Policy makers play an important role in safeguarding financial stability**
  - Aim for an early, smooth and clear transition
  - Implement better climate related reporting standards (TCFD)
  - Keep supervisory frameworks risk neutral

Supervisors

- **DNB is going to take steps to integrate climate risks into supervision**
  - Address climate risks in supervisory conversations
  - Developing and implementing climate stress tests
  - Building and sharing knowledge (Platform for Sustainable Finance, NGFS)

Next steps

DNB is taking further steps to embed climate-related risks more firmly into her supervisory approach

Climate-related risks may increase in the years ahead

Institutions must identify and manage these risks appropriately, supervisors need to supervise this.

past ≈ future

past ≠ future

We are taking steps to embed climate-related risks more firmly into our supervisory approach:

1. Incorporate climate-related risks in assessment frameworks
   - Preferably so-called 2nd and 3rd pillar of capital framework (e.g. ORSA and ORA)
2. Continue to work on the implementation and further development of climate stress tests and scenario analysis
3. Promote international exchange of best practises
   - Network on Greening the Financial System (NGFS) & Sustainable Insurance Forum (SIF)

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Next steps

The European Commission is driving the sustainable finance agenda in Europe

European Commission

KEY CHALLENGES	ACTIONS	
No common definition of 'sustainable investment'	EU classification (taxonomy) for sustainable activities	RELIABLE INFORMATION
Risk of 'greenwashing' of investment products	Standards and labels for 'green' financial products give investors certainty	
Banks and insurers often give insufficient consideration to climate and environmental risks	Study if capital requirements should reflect exposure to climate change and environmental risks	SUSTAINBILITY AND RISK MANAGEMENT
Investors often disregard sustainability factors or underestimate their impact	Clarify institutional investor duties to consider sustainable finance when allocating assets	
Too little information on corporate sustainability-related activities	Enhancing non-financial information disclosure	LONG-TERMISM IN GOVERNANCE

In our view the Green Supporting Factor is not the right policy instrument

- Proposed to **stimulate green investments**
- Reduction in Risk Weighted Assets for green investments (pillar 1)
- However: capital requirements serve to protect the **soundness and safety of the financial system** and there are better tools to achieve climate goals

Thank you

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