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# Roundtable: "Sustainable Finance as the driving force of the ecological transition"

Banco de España

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It is a pleasure for me to welcome you to the Banco de España for two reasons. First, because I believe the Bank should be a forum for discussing and bringing closer to society those financial matters that bear on and affect the well-being of all. The second reason has to do with the matter I shall broach today, which I consider to be particularly important and which is none other than the role finances can and should play in relation to combating climate change.

As you all know, this is not a new objective. Indeed, at least since the 1992 Río de Janeiro United Nations summit, combating climate change has been a recurrent objective of international institutions. So, what has changed in the wake of the 2015 Paris agreement, and why has climate change also begun to be part of the financial authorities' agenda?

Mark Carney talked about the so-called "tragedy of the horizon", in the sense that the horizons used in the evaluation of financial risks are shorter than those that should be applied to evaluate climate change. Yet these risks may be said to have moved onto our horizon; both the physical risks owing to the effects of climate change, and above all, the risks of transition towards a sustainable economy.

The Paris agreement marked a turning point regarding the feeling of urgency in the fight against climate change. Along with reflecting the risks, the agreement explicitly acknowledges how important the financial system should be for efficiently channelling the resources needed to transform our economy towards a sustainable model.

These two factors, namely the risks and the opportunities and incentives associated with the change in economic model to combat climate change, have grown in significance on international financial agencies' agendas. Allow me to mention, non-exhaustively, some of these initiatives:

- the work on sustainable finance during the last three mandates of the G20,
- the establishment of responsible investment principles by the United Nations,
- the creation of the Financial Stability Board's Task Force on Climate-related Financial Disclosures,
- the establishment of the OECD green finance and investment centre,
- the Sustainable Banking Network established by the World Bank,
- within the EU, the European Commission's action plan on sustainable finance
- in the central banking and banking supervision environment, the work by the Network for Greening the Financial Sector (NGFS), of which the Banco de España is a member.

In sum, the Paris agreement message to involve the financial sector has hit home and is prompting numerous courses of action.

You will be discussing many of these initiatives at length in the ensuing roundtable. But in the rest of my speech I wish to briefly set out the role the Banco de España, as a central bank and as a supervisor, can perform regarding this collective challenge.

Both the effects of climate change and of the measures geared to sustainably transforming our economy affect credit institutions directly. First, these risks bear directly on the valuation of some of the assets on bank balance sheets. Further, they have macroeconomic consequences which, evidently, likewise affect balance sheets. In either of the two cases, banks' solvency under our supervision might be affected by processes which, as supervisors, we should monitor.

In this respect the Banco de España, as one of the guarantors of financial stability, should contribute to fomenting the correct valuation by banks of these risks and mitigation of their financial effects. These measures may vary in nature, including aspects such as:

- urging banks to develop risk models that envisage climate change;
- developing stress tests based on different scenarios of ecological transition;
- gathering detailed information on aspects such as the physical location of assets or the efficiency strategies of firms that receive financing.

As to the role of banks ahead of this challenge, let me stress that if in the near future banks properly identify, quantify and mitigate these risks, this would not only be a contribution to ensuring the stability of the financial system as a whole; moreover, banks themselves would indirectly be acting as a catalyst for change by helping financing reach those activities that most contribute to the sustainable transformation of our economy. They would also be discouraging those activities potentially most harmful to the environment, by having hitherto hidden environmental costs passed through to the price of financing.

Also, as supervisors, we should move to develop models that envisage macroeconomic effects in the face of different ecological transition scenarios. The aim hereby is to become familiar with the potential impacts of climate change on specific economic sectors, industries and even firms, and on more aggregate variables, such as growth and inflation.

Naturally, the implementation of many of these initiatives requires considerable international coordination. Hence the importance of our active participation in the NGFS, the supervisors' and central bank network I mentioned earlier, set up in early 2018. In the short time since its creation, the NGFS has managed to bring together more than 30 central banks and supervisory authorities. The aims of this network include analysis of supervisory practices, of macroeconomic and financial risks, and the means for smoothing financing for the transition to a sustainable economy. Undeniably, the implementation of all these aspects with some degree of harmonisation will be a difficult task. But you will agree with me that we are all facing a fundamental challenge and that, as such, we must spare no effort.

Allow me to refer briefly also to the role financial markets can play in this process of ecological transition. In capital markets we have seen some positive discrimination in the valuation of firms with a lower degree of exposure to climate change, albeit limitedly so. Logically, and as in the case of banks, the markets should act as a catalyst for change towards certain sustainable activities, while discouraging investment in particularly polluting industries.

Evidently, the attractiveness for investors of issues of green bonds is a sign of the growing concern over the effects of climate change. Yet for the aforementioned transmission mechanisms to work properly, the volume of securities traded on these markets must reach a critical mass and be consistently catalogued. To achieve this, the initiatives developed within the European Commission are essential: these include most notably the taxonomy for determining the activities that contribute to sustainability in environmental terms, and the "ecological" labelling of financial products. We need a common language that can be used both by debt issuers and potential investors, so that these markets may be developed.

On this point of financial investments categorised as "green", it is worth recalling that we as central banks are also active investors in financial markets, both in monetary policy operations and in portfolio management relating to reserves. In this connection, as acknowledged in the report by the network of central banks and supervisors, and as recently indicated by Mario Draghi, we are aware that environmental risks are not yet being built into most of this portfolio's ratings, whether internal or devised by rating agencies.

Accordingly, in the Eurosystem, a thorough review of these risk valuation processes is under way. The aim is to ensure us that all the relevant factors, including environmental ones, for the prudent management of the portfolio held by the central banks are being taken into account. In addition, I should point out that, like the ECB, we resolutely support the initiative recently launched by the European Securities Markets Authority (ESMA). As the regulator of rating agencies, ESMA is seeking to establish guidelines so that these entities make public the way in which they incorporate sustainability elements into their valuations.

To conclude, allow me to reiterate the importance and scale of the challenge we face. It may sound clichéd; but it is nonetheless true that we are not only talking about our well-being, but the well-being of future generations who may be left with little leeway if we are not sufficiently ambitious. The challenge extends to all agents and sectors, and proof of this is the broad and varied representation here in this room today. The financial sector undoubtedly has a notable responsibility in this challenge. In our capacity as financial authorities and under our mandate, we can and must do everything within our power to properly value, manage and mitigate the risks associated with climate change. The challenge is paramount and the need for coordination – with other national and international authorities – enormous. But I believe that, if we have been capable of structuring an appropriate regulatory response to the international financial crisis, we will also be capable of rising to the challenge here.

I think that the measures rolled out from Europe will ultimately be an international reference and standard. And we will in this way manage to make the financial sector contribute actively and efficiently to the sustainable transformation of our economy.

I trust the following discussions will prove interesting for you. We will talk about the important work by European institutions under way, about how financial institutions are adapting and about the way in which the adverse effects the energy transition may exert should be accommodated, in what has come to be known as the "fair transition" debate.

Thank you.