



**Lee Kuan Yew School of Public Policy
Singapore, 14 November 2017**

**Lecture by Anne Le Lorier
First Deputy Governor of the Banque de France**

**“Catching up? The financial sector and the challenges of climate
change”**

Ladies and gentlemen,

It's my great pleasure to be in Singapore tonight, one of the greenest cities in the world. Despite its density, Singapore has achieved impressive successes in energy efficiency buildings as well as in water cleaning. The most popular one is that river otters are back and doing well. But beyond the preservation of biodiversity and its participation to the endeavors against climate change, Singapore is also taking some impressive steps to become the leading financial hub in Asia for green finance.

Mainstreaming green finance is not an option anymore, it is a necessity. Climate change is already a reality and comes with potentially significant impacts on our economies. The taxonomy of climate related risks (physical risks, transition risks, liabilities risks) likely to affect the entities of the financial sector is now well-known, I would therefore like to focus my intervention today on the new opportunities generated by the transition to a low-carbon economy as well the challenges to tackle in that regard.

First, let me underline that financing the transition to a low carbon world economy requires to shift trillions of dollars within a very short time frame. Achieving the objectives of the Paris agreement would require, according to the OECD, 95 trillion USD to be invested globally in infrastructures (energy, transportation, water, telecommunication) between 2016 and 2030, i.e 6 300 billion USD a year. Between 60 and 70% of that amount would be needed in emerging countries. There are therefore two key factors of success in financing the transition: scale and time.

Of course, we are not starting from zero and the financial sector in advanced or emerging economies has already understood that financing the transition was a source of opportunities (I). However, a number of obstacles still need to be overcome (II) to scale up and mainstream green finance. Last but not least, public authorities have a role to play (III) both to make sure that the financial sector is well equipped to cope with climate related risks and to create a favorable environment for green finance to “flourish” if I may say so.

l) The financial sector in advanced or emerging economies has already understood that financing the transition was a source of opportunities

The market, both on the sell and buy sides has clearly identified green finance as a new opportunity and as a way to align private and public interests. Financial institutions have developed innovative voluntary approaches, such as the Principle for Responsible Investments (PRI), supported by the United Nations which gathers 1 800 asset managers accounting for trillions of investments. In the same vein, the CERES investors network is a market initiative which comprises 130 institutional investors managing 17 trillion USD in assets to deal with sustainability challenges. In other countries, such as in France, the law (to be precise the article 173 of the August 2015 law on energy transition) contains some requirements in terms of carbon disclosure applicable to banks, insurers, listed corporations and institutional investors' exposures and in terms of setting out their strategy toward low carbon economy. At the international level, the private sector-led FSB Climate Disclosure Task-Force has published its voluntary recommendations pertaining to climate-related financial risk disclosures for companies and financial institutions. The publication was accompanied by statements of support from more than 100 firms with a market cap of over 3.3 trillion USD and financial firms responsible for assets of more than 24 trillion USD. And the numbers are growing.

As a result, green finance has already started to gain scale at a global level. There are around 900 billion USD climate-aligned bonds in 2017¹, including 221 billion USD of labelled green bonds. The market is gradually gaining speed and nearly doubled in volume last year. These figures do not reflect the entire reality of green capital flows: bank loans, for instance, can have and are already having a tremendous contribution to the transition, but the lack of reporting and of a green asset taxonomy hinders a reliable estimation of the flows. **In this promising dynamic, financial innovation is key.** Green bonds are an extremely useful tool to scale up financial flows, thanks to enhanced transparency on the assets and the processes. New perspectives emerge with the green securitization, green covered bonds which could help reaching smaller projects, as for instance householders' investments in electric car or thermal renovation or SMEs and diversify green asset classes.

¹ Source: the Climate bond initiative, 2017 https://www.climatebonds.net/files/files/CBI-SotM_2017-Bonds&ClimateChange.pdf

With this background, the Paris financial center is striving. For instance in 2016² France was the third largest green bond issuer, after China and the US and Paris could be the first one in 2017. The particular situation of the French financial sector could be explained by its historical expertise in responsible investment and a complete value chain for green finance, i.e public and private issuers, third party reviewers, investors, arrangers and book runners and in particular for green bonds. The issuance of the biggest green sovereign bond at €7bn in January 2017 has been a key milestone. The so called “green OAT” is the first sovereign issuance with such detailed commitments in terms of transparency, reporting and impact assessment. The funds will be used by the French Government to finance a variety of policies, such as building, transportation, energy (outside nuclear energy), biodiversity, adaptation and fight against pollution. Moreover, French corporate issuers are among the most active, such as Engie who issued the biggest private green bond (€2.5Bn in 2014), investors, third party reviewers and arrangers.

Some emerging economies have also clearly identified climate as the most challenging issue in their search for a sustainable development. China for instance is moving fast to foster the transition path through green credit, green development funds, stimulation of the green bond market in order to increase investment in sustainable infrastructure for energy, land use and urban development. India is among the top 10 green issuers in the world. For instance the Security and Exchange Board of India (SEBI) released guidelines in May 2017 on issuances across sectors, reporting, the impact of green bonds.

Against the backdrop of the massive financing needs, green private finance cannot be the only answer and would have to be “blended” with or complemented by public finance and financial development assistance. Some projects, such as transportation or energy infrastructure, might require too much funds or are too risky to be borne only by private investors. In this case, public finance is a crucial leverage to start new projects that will reach both development and sustainability purposes. Multilateral Development Banks’ (MDB) commitments for climate finance reached 27.4 bn USD in 2016³.

² Source : HSBC <http://www.latribune.fr/entreprises-finance/banques-finance/la-france-numero-3-mondial-durable-de-la-finance-verte-754877.html>

³ <http://www.eib.org/attachments/press/2016-joint-report-on-mdbs-climate-finance.pdf>

- II) Even though these developments are promising, we are still far from the scale needed to successfully finance the transition to a low carbon world economy. A number of obstacles still need to be overcome to scale up green finance and achieve the scale needed to finance the transition**

First, the increasing mobilization comes with new questions regarding the definition of green. What is green and can/should its definition be standardized? As some analysts say, there are “50 shades of green”. Authorities should make sure that the scaling-up of the green asset markets, green bonds and green loans in particular, takes place in an orderly manner and that market integrity is preserved. One key aspect for scaling up is to prevent the risk of “green washing”. The “greenness” of an underlying asset highly depends on the label or green rating methodology you are using. For instance, in some emerging countries, green bonds can finance clean coal or nuclear plants. In my opinion, it is necessary to adapt the taxonomy to where the country stands in terms of development and energy mix. What is considered not green in France, such as coal, differs from the Indian perspective for instance. **The second question has to do with the pricing advantage of green assets.** Green comes with advantages in the long run but could be more expensive in the shorter run due to higher transaction costs. For instance, green bond labelling has a cost, which could deter issuers. That is the logic of the Green Bond Grant Scheme, launched by the Monetary Authority of Singapore (MAS) which covers the costs of green bond external review. Progressively, green bond issuance seems to offer the issuer a financial benefit, due to a strong demand. The emergence of a green premium⁴ is a good sign. Once this premium exceeds the cost of external review, the market will certainly grow even quicker. **Third, disclosure/reporting requirement is also key.** Disclosure is a powerful tool of market discipline and a strong way to incentivize financial actors to factor in transition risk in their investment decisions. The FSB Climate Disclosure Task-Force has provided a useful set of tools to help companies and financial institutions in this endeavor. However, there is not yet a commonly accepted methodology to assess companies’ carbon emissions and therefore not a single way to assess financial institutions exposure to climate risks and opportunities.

- III) To scale up green finance public authorities have an important role to play both to make sure that the financial sector is well equipped to cope with climate related risks and to create a favorable environment for green finance to flourish if I may say so.**

⁴ <https://www.climatebonds.net/2017/09/green-bond-pricing-primary-market-there-greenium-latest-analysis-climate-bonds>

The mainstreaming of green finance requires a strong and continued commitment of authorities. Among the numerous tools at their disposal, some are critical such as defining a long term path for the transition to guide market participants, protect market integrity and prevent financial risks, as well as creating a favorable environment for green finance. In the meantime, misconceptions have to be fought against. There cannot be a sectoral use of monetary policy such as giving privilege to green collateral or resorting to a green quantitative easing. Nor can supervision ignore risks, be they attached to green projects. **The first challenge, in my opinion, is to provide long term signals to the financial sector.** At this stage, there are two possibilities: either the authorities implement at an early stage the policies required to respect the 2°Celsius scenario, resulting in a smooth transition or they delay their policy responses to climate change, leading to a *too late too sudden* (ESRB, 2016) scenario and significant economic damages. **The key instrument for a soft landing is a credible carbon price.** France has recently amplified the ambition of its carbon tax. The level of carbon tax prices set on energy products should reach 44,6€ per ton of CO₂ in 2018, 65,4 €/t CO₂ in 2020, 86,2 €/t CO₂ in 2022. Europe has agreed in February this year to further strengthen its carbon market. China has made two years ago the promising announcement of the launch of a carbon market and seems to be on the verge of implementing it.

Other policies could be emphasized, such as the decision in France to ban sales of petrol and diesel cars by 2040. The timescale provides a clear long term signal to manufacturers, financial markets and consumers. These policies are key to align incentives and anchor expectations of market participants. They reveal risks and opportunities of the transition. This means there will be losers in the transition process: those are the companies and financial institutions that will not adapt early enough their long term strategy and business model.

A second challenge stems from the development of green assets: how could the authorities encourage the scaling-up of the markets without damaging market integrity regarding the actual greenness of the underlying assets? The idea of a voluntary green bond label that is more strictly defined than current labels is relevant but can in practice only apply to a region where the same conception of “green” prevails, for instance at the EU level. In the same vein, the identification of green loans for householders or SMEs through an agreed taxonomy and the emergence of new financial products such as, for instance, green securitization are key for scaling up investments.

One of the objectives of the French green sovereign bond was precisely to establish a high level benchmark for the market. This issuance goes with an unprecedented tracking and reporting commitments for a green bond: it was reviewed by two agencies, it followed the best practices regarding labelling and a “Green Bond Evaluation Council” made up of independent scientists and economists of international repute will monitor and evaluate the environmental impact.

Furthermore, the French Government endorsed a Label for the Energy and Ecological Transition in 2015. This label covers funds dedicated to financing the green economy, including funds invested in listed equity, private equity, green bond and infrastructure.

Third, climate change comes with new financial opportunities but also with new financial risks. There is a consensus among policy makers, especially central banks and supervisors which have a financial stability mandate, around two approaches to help assessing the risks: the provision of environmental data through disclosure and conducting scenario based risk analysis. **Scenario based risk analysis** is a useful instrument to ensure that financial institutions are able to assess their own exposures to climate related risks and to mitigate them based on the likelihood of several scenarios of risk materialization. This methodology is meant to help banks identifying to which extent climate related risk may affect their risk profiles (credit risk mostly but also market risk and possibly operational risk) in ways which may not be captured in basic capital requirement or pillar 2. That’s the approach put forward in the report jointly elaborated by the Treasury and the Banque de France/ACPR for climate related risk analysis in the French banking sector. That is also the purpose of the work undertaken at the G20 level under German presidency. The group has produced a synthesis report covering risk analysis, based on case studies, and data availability. More generally, many authorities and financial institutions have developed such analysis under different forms. **Fourth, the authorities have to create a favorable environment and a political momentum both at a national level and at an international level.** It is crucial, to structure and mobilize the different stakeholders of green finance. In France, a joint initiative called “Finance for Tomorrow” brings together banks, insurance companies, asset managers, issuers, external reviewers and public authorities committed to build up a sustainable financial sector. The various work streams are very dynamic, as the Climate Finance Day which will take place on December 11 in Paris will show.

Last and not least, we must preserve, at a global level, an open multilateral dialogue between our countries and financial centers. Climate change will affect all and every one of us. We should share more on the ways to allocate capital where it is the most needed. A strong coordination between authorities and financial centers will be critical in overcoming climate change challenges.

Conclusion

To conclude, I would like to highlight that **there is no such thing as “one best way”** to develop green finance. In the light of our experience in France, it seems that there are indeed a number of preconditions to be met for developing a successful green financial center, however financing the climate transition is a global challenge which requires a global cooperative approach.

In this perspective, two years after the successful of the COP 21, France organizes the **“One Planet Summit”** on December the 12th in Paris to accelerate the movement to moderate Climate change.