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Same storm, different boats

Solving the climate emergency with no one left behind

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Same storm, different boats

The determination to 'build back better' with a sustainable recovery has dominated the vision for the economic and policy response to the pandemic, writes Danae Kyriakopoulou, chief economist and director of research, OMFIF.

IN recent years, more than 100 countries have pledged to achieve net-zero emissions by 2050 or earlier. But while the destination is common to all, countries differ widely in their abilities and resources in terms of how – and how quickly – they can reach it. This is because while, as a planet, we are all in the same climate storm, we are not all in the same boat.

A perhaps simplified but useful distinction is the difference between developed and developing economies. This applies in at least two ways. First, owing to a mix of economic and geographic factors, the physical risks from the climate crisis are highest in the global south. From India to Southeast Asia and Latin America to Africa, developing countries are being hit hardest by natural disasters (p.8 and 11).

Second, while developed economies have undergone decades of industrialisation and economic growth without the constraint of 'internalising' environmental considerations, developing countries are now denied the same opportunities. This is the right thing to do – the climate crisis is an existential threat, and just because policies were misguided in the past it does not mean others should follow them for the sake of equality.

But that does not mean that concerns over fairness and justice should be ignored. There are other ways to level the playing field. This edition of the SPI journal assembles recommendations for how to deliver a just transition. They include proposals for developing transition finance solutions (p.16), prioritising re-skilling, access to finance and transfer payments systems (p.15), and highlight the role of central banks in managing the risks of inequalities and 'stranded jobs' (p.12 and 18).

These risks are not only present in developing countries. Inequalities have also been widening within advanced economies. Parallels can be drawn with globalisation: despite substantial net benefits to the global economy, their unequal distribution gave rise to backlash movements. We cannot afford the same with climate change. Unlike globalisation, the counterfactual of policy reversal in this case will have existential consequences. To avoid it, it is imperative that we design a climate transition that is not only green, but also just. •

'While the destination is common to all, countries differ widely in their abilities and resources in terms of how – and how quickly – they can reach it.'

Key policy decisions on sustainability, April – May 2021

Taskforce on Nature-related Financial Disclosures launches

The TNFD aims to build on and complement the work of the Task Force on Climate-related Financial Disclosures, to give companies and financial institutions a complete picture of their environmental risks. The reporting framework will be tested and refined in 2022 before its launch in 2023.

Japan's Financial Services Agency and the Tokyo Stock Exchange creating green bond certification framework

Supporting the issuance of corporate bonds, the Japanese regulator is building a framework to certify green and transition bonds and promote the decarbonisation of industries. It is intended to provide guidelines and encourage funding in sustainable finance.

Bank of England plans to shift its corporate bond buying programme toward decarbonisation

The central bank has proposed four key tools for greening the corporate bond purchase scheme focusing on portfolio targets, asset eligibility, tilting purchases and tightening requirements.

Banque de France launches Climate Change Centre

The BdF has set up a climate change centre to monitor its climate initiatives and ensure they are consistent with the priorities of the Central Banks and Supervisors Network for Greening the Financial System.

Selected central bankers' speeches on sustainability

27 May: Luis de Guindos, vice president, European Central Bank, on climate change and financial integration

21 May: Andrew Hauser, executive director, markets, Bank of England, on how central banks can use monetary policy portfolios to support transition to net zero

21 May: Marja Nykänen, deputy governor, Bank of Finland, on maintaining the European Union as global leader in sustainable finance

20 May: Ravi Menon, managing director, Monetary Authority of Singapore, on a vibrant carbon market for a low-carbon future

18 May: Sarah Breeden, executive sponsor climate change and executive director, UK Deposit Takers Supervision, Bank of England, on plotting our course to net zero

13 May: Tiff Macklem, governor, Bank of Canada, on the benefits of an inclusive economy

12 May: Isabel Schnabel and Frank Elderson, ECB executive board members, on tackling climate change as a central bank

6 May: Christine Lagarde, president, ECB, on a green capital markets union for Europe

4 May: Ignazio Visco, governor, Banca d'Italia, on raising the bar on climate ambition

29 April: Frank Elderson, vice chair of the ECB supervisory board and member of the executive board, on guiding banks towards a carbon-neutral Europe

19 April: Gabriel Makhlouf, governor, Central Bank of Ireland, on tackling the challenges of Covid-19, digitalisation and climate change

16 April: Jorgovanka Tabaković, governor, National Bank of Serbia, on developing an environmentally supported and orientated domestic economy

15 April: Yi Gang, governor, People's Bank of China, on green finance and climate policy

12 May

21 May

FURTHER READING

Selected reports on climate change and sustainable finance, April - May 2021

ShareAction – Paris-alignment methodologies for banks: reality or illusion?

The report aims to establish best practice recommendations for Paris-alignment of bank portfolios.

International Capital Market Association – Overview and recommendations for sustainable finance taxonomies

This paper provides an international overview of both official and market-based taxonomies. It summarises the various approaches and objectives that are being pursued.

Grantham Research Institute on Climate Change and the Environment – G7 leadership for sustainable, resilient and inclusive economic recovery and growth

Prior to the G7 summit from 11-13 June, the report sets out the challenges and opportunities facing the world, as well as the shared vision, strategies and priorities for action.

Cambridge Institute for Sustainability Leadership – Understanding the climate performance of investment funds

The first of two reports analyses the approaches currently used to measure and report investment funds' climate performance. It makes a case for temperature scores to act as a universal measure of climate performance for the industry.

Finance For Biodiversity Initiative – Debt and biodiversity: A Chinese leadership opportunity

This consultation document sets out the opportunities for China to engage with international policy, their role in debt markets and emerging market developments around biodiversity.

United Nations Environment Finance Initiative, Climate Safe Lending Network – Aligning finance for the net-zero economy: New ideas from leading thinkers

The report outlines the practical policies financial regulators could adopt if given the responsibility of regulating the financial system in line with the needs of society and the planet.

Bank for International Settlements – Climate-related risk drivers and their transmission channels

This report explores how climate-related risk drivers, including physical and transition risks, can affect both banks and the banking system via micro- and macroeconomic transmission channels.

BIS – Climate-related financial risks: measurement methodologies

This provides an overview of conceptual issues related to climate-related financial risk measurement and methodologies, as well as practical implementation by banks and banking supervisors.

Asian Development Bank – Asian Development Outlook 2021: Financing a green and inclusive recovery

The report presents economic prospects for developing the Asia Pacific region. It analyses the impacts of closures caused by the pandemic and financing a green and inclusive recovery.

International Monetary Fund – G20 note on environmentally sustainable investment for the recovery

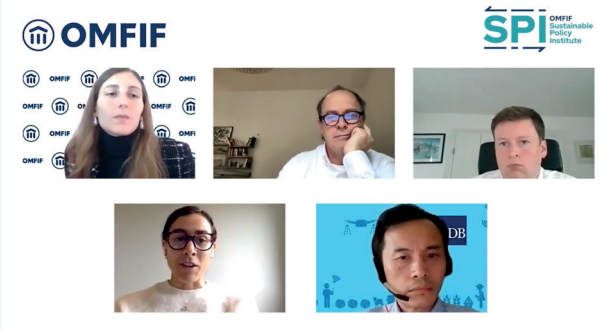
This paper summarises the main findings of the IMF's flagship reports regarding the role of environmentally sustainable investment for the recovery.

OMFIF's latest sustainable finance activity

MEETINGS

OMFIF meetings held in April and May covered a variety of topics. They included biodiversity, risk exposure, the role of capital markets in climate change and fireside conversations with central bank officials and climate experts.

26 May: Establishing metrics for biodiversity and ecological transition



21 May: Taxonomy and transition pathways: Risk exposure and financial activities

17 May: In conversation with Ben Caldecott: The Centre for Greening Finance & Investment

11 May: The role of green loans and targeted lending in providing economic growth

5 May: In conversation with Olaf Sleijpen: Quantifying the risk of climate change to financial stability

28 Apr: Stress testing and climate scenario analysis: Providing transparency and pathways for mitigating climate impact

15 Apr: In conversation with Kevin Stiroh: The role of the Federal Reserve in mitigating climate-related financial risk

PODCASTS

In April and May, podcasts covered the importance of gender diversity in financial institutions, the Federal Reserve's progress in mitigating climate risk and how financial systems can play an important role in the climate crisis.

27 May: Gender diversity in leadership and decision-making in the financial system

4 May: In conversation with Kevin Stiroh: The role of the Federal Reserve in mitigating climate-related financial risk

29 Apr: Designing a financial system that responds to the climate threat and promotes a healthy planet

COMMENTARIES

Commentaries in April and May included topics such as sustainable infrastructure, climate leadership, climate risk management and central bank strategies for transitioning to a net-zero economy.

26 May: Luca Bertalot – Housing finance is a pillar of sustainability

19 May: Emma McGarthy – Stress testing is integral to green transition

6 May: Dael Wilson – Asia Pacific working to narrow ESG gaps

27 Apr: Janine von Wolfersdorff – European Commission paves way for green accounting standards

26 Apr: Emma McGarthy – Building financial resilience in small island states

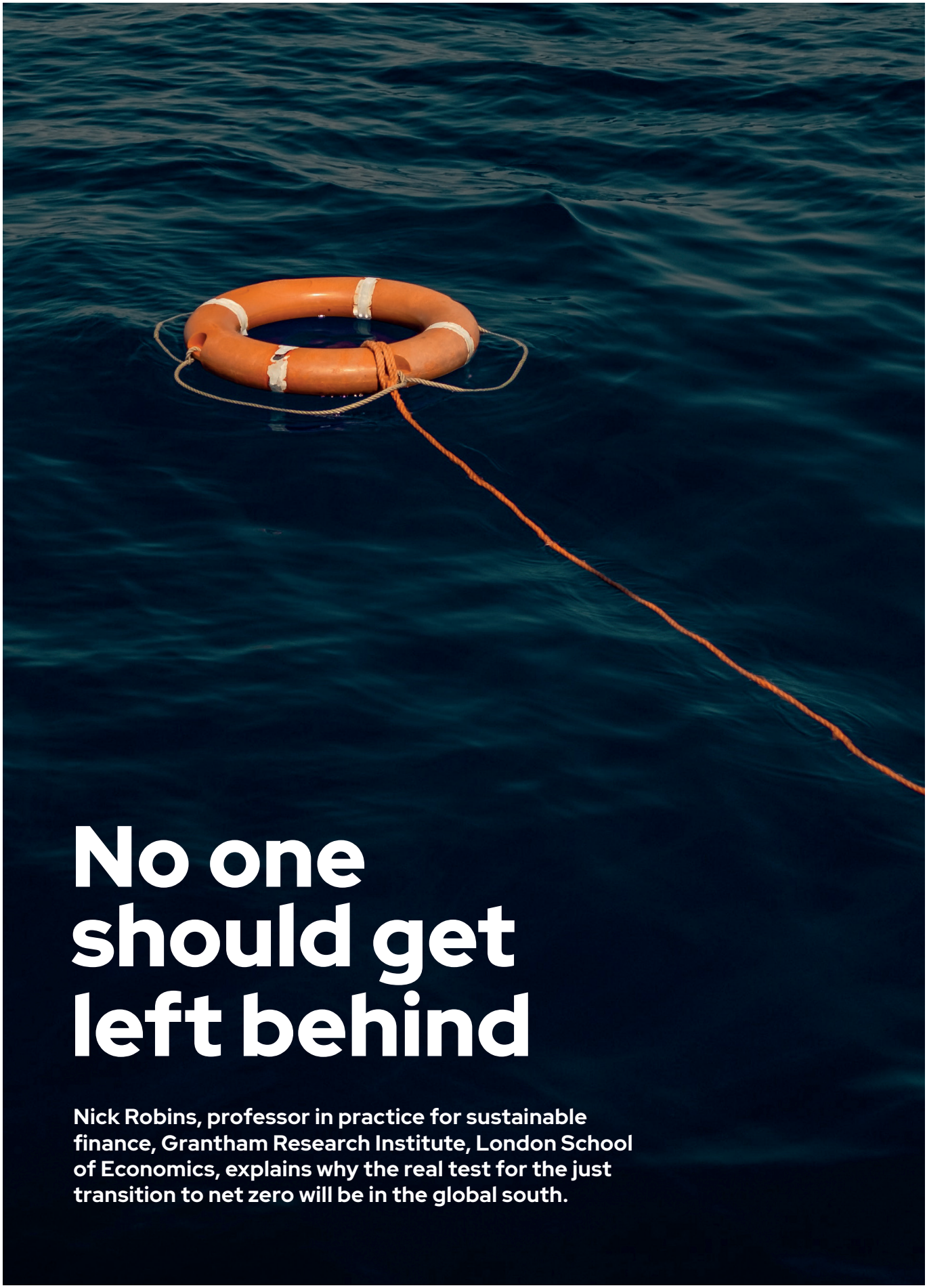
23 Apr: Philip Moore – Sustainable inflows break new records

21 Apr: Danae Kyriakopoulou, David Marsh and Mark Sobel – Biden's climate challenges: China data, turf wars

19 Apr: Steve Bowen – Risk management opportunities: climate change and Covid-19

15 Apr: Philip Moore – Emerging markets embrace sustainable bond agenda

14 Apr: Nick Robins, Simon Dikau and Ulrich Volz – Net-zero central banking gathers momentum



No one should get left behind

Nick Robins, professor in practice for sustainable finance, Grantham Research Institute, London School of Economics, explains why the real test for the just transition to net zero will be in the global south.

THE need to shift to a net-zero economy is gaining powerful traction across governments and the financial system ahead of the COP26 summit in November. As the world emerges from the Covid-19 crisis, accelerating investments in climate action and the restoration of nature are no longer seen as a burden, but rather as a driver of economic recovery, job creation and innovation.

The world's emerging markets and developing countries could be the greatest beneficiaries of this shift. According to Carbon Tracker, Africa has the potential to be a 'renewables superpower' with its abundant access to cheap solar and wind power. Reaching net zero as soon as possible will reduce the growing burden of damage from climate change impacts, which falls hardest on developing countries who have contributed least to the problem. Immense health benefits will also be achieved as urban air pollution is reduced or even eliminated, saving millions of lives across the global south.

Realising this huge potential will not happen automatically. By definition, developing countries still face structural deficits in meeting basic development needs and these have been exacerbated by the pandemic. In the coming decades, net-zero investment will be most needed in emerging economies. Nick Stern's report for the UK prime minister ahead of this year's G7 summit estimated that global investments of $2.6tn–$3.2tn a year will be needed to deliver the required transitions in energy and resilience. Only a quarter of this investment is needed in the richest economies of the G7.

Beyond $100bn

Getting these trillions of net-zero investments to flow in emerging markets will require a realignment of the global financial system. This means tapping into domestic pools of capital – not least in the banking sector – as well as securing international flows of climate finance far larger than the $100bn per year commitment in the Paris agreement. This will require scaling up investment and confronting structural constraints in underdeveloped financial markets, high costs of capital and incomplete financial inclusion.

Importantly, the assumption that high-income countries are where carbon emissions are highest – and therefore where decarbonisation efforts will be toughest – no longer always holds true. The UK's carbon emissions peaked in 1973 and the European Union's in 1979 as de-industrialisation, offshoring and the shift to gas from coal got underway, long before climate policy took effect. According to the World Bank, the UK's domestic emissions stood at 5.8t per capita in 2016, while China's had reached 7.2t pc and South Africa's 8.5t pc. The US still had far higher emissions per capita at 15.5t in 2016, but its emissions peaked in 2007. This trend will only have deepened since 2016.

'We remain committed to contributing our fair share to reduce global emissions, and to do so in the context of overcoming poverty, inequality and underdevelopment.'
South African President Cyril Ramaphosa

Crucially, this trend in high-income country emissions is production-based – it does not reflect imports from developing countries. A heavy reliance on production for export is another reason why, as carbon risks intensify in the global economy, it is the global south that is increasingly carrying the burden of exposure.

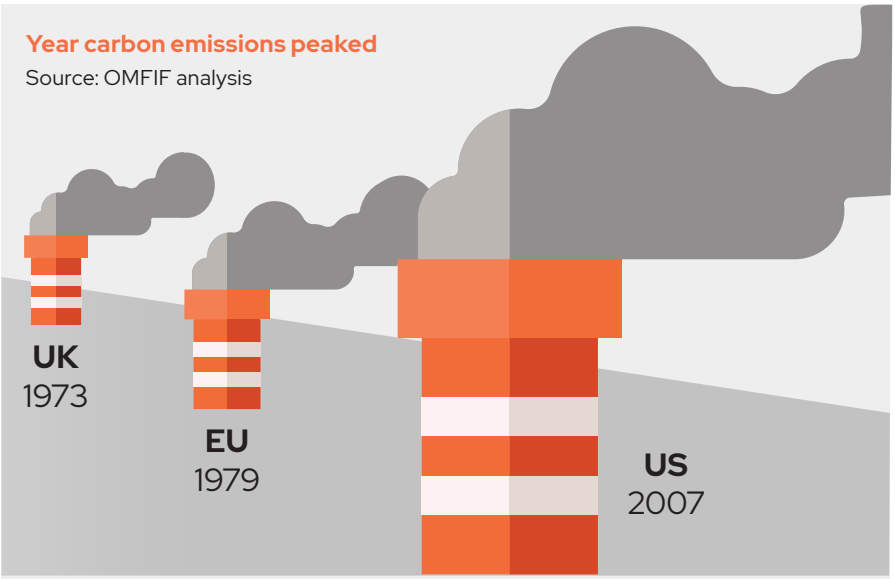
This point is not lost on decision-makers in major emerging economies. Speaking in April, Governor Yi Gang of the People's Bank of China observed that, 'It will take 70 years for the EU, 45 years for the US and about 30 years for China to move from carbon peak to net zero', and that 'The time is shorter and the curve is much steeper for China.' For Gang, the conclusion was clear: 'It means our financial institutions are faced with grave risks and should begin their green transition right away.' In India, Dr Arunabha Ghosh and Vaibhav Chaturvedi of the Council on Energy, Environment and Water have noted that, 'If India peaked in 2030, per capita emissions would be 2.2 tonnes. China's per capita income in its peaking year of 2030 would be $29,438 (in purchasing power parity terms); India's would be $8,779. When the US peaked emissions, each citizen was earning [on average] $55,916.' In India, getting to net zero offers huge potential, but it will happen at a lower level of development and require more effort, including how to find alternative employment for over half a million coal mining workers.

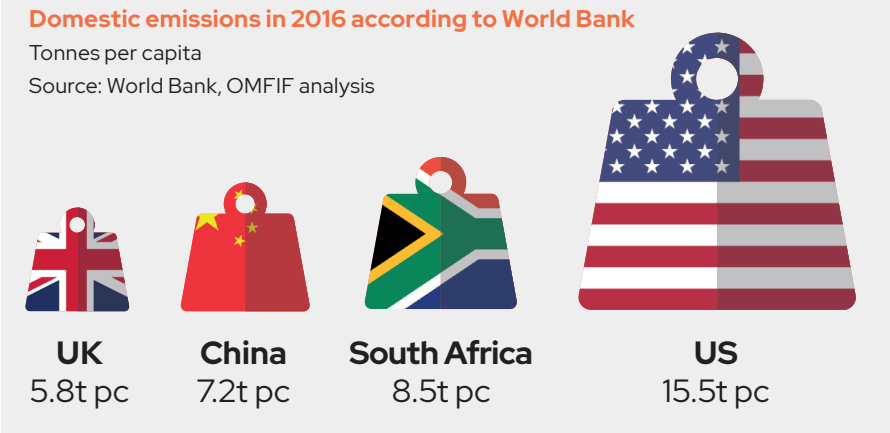
Just transition for emerging markets

Delivering a just transition is an important part of the strategy for achieving net zero across the global south. Long championed by the trade union movement, it is incorporated by the Paris agreement as a way of making sure that the interests of workers and communities are placed centre stage.

The financial sector's focus on climate risk has prioritised the avoidance of 'stranded assets'. The just transition means widening this view to include the avoidance of 'stranded jobs' and potentially 'stranded countries', especially the increasingly carbon-intensive economies in emerging markets. And the just transition goes beyond 'leaving no one behind' in high-carbon sectors and regions. It also means ensuring that the new green jobs in the expanding renewables sector are good jobs, providing decent work and boosting local economies.

After a series of false starts – remember the 2018-19 gilets jaunes protests in France? – political leaders increasingly recognise that a just transition is essential to achieving net zero. The EU has established a Just Transition Mechanism to mobilise €150bn by 2027 to support the regions most affected by its Green Deal programme. In the US, President Joe Biden has made clear that the solutions to the climate crisis offer historic 'opportunities to create well-paying





union jobs' and 'deliver an equitable, clean energy future'.

But it is not only post-industrial countries that recognise the imperative for a just transition. Speaking at Biden's climate summit in April, South Africa's President Cyril Ramaphosa made clear his commitment to 'contributing our fair share to reduce global emissions' in the context of 'overcoming poverty, inequality and underdevelopment'. For Ramaphosa, this means that a 'climate-resilient future… must be based on a just transition that ensures that those who are most vulnerable in society do not get left behind.'

Critical to COP26 success

Financing a just transition strategy that connects climate action with building better livelihoods is therefore essential across emerging economies and the developing world. North–south climate finance flows need to be doubled, according to Stern, and commitment to the just transition will be key to 'ensure that the benefits and opportunities are shared widely'.

'It means our financial institutions are faced with grave risks and should begin their green transition right away.'
Yi Gang, Governor of the People's Bank of China

With more than 70 low-income countries either in debt distress or at high risk of debt distress, boosting international public finance through grants and concessional mechanisms will be important. Extra funding from multilateral development banks will also be vital to support in-country just transition plans. The European Bank for Reconstruction and Development and the World Bank have introduced dedicated programmes for the just transition. These will need to be expanded to all MDBs as the momentum to phase out coal and other fossil fuels intensifies.

In the US, President Joe Biden has made clear that the solutions to the climate crisis offer historic 'opportunities to create well-paying union jobs' and 'deliver an equitable, clean energy future'.

As guardians of the financial system, central banks in emerging markets will also need to incorporate an explicit focus on the just transition. This could involve connecting their longstanding commitment to financial inclusion with their growing response to the climate crisis. This more promotional role could involve tools such as India's well-established priority sector lending programme.

Heading into COP26, all countries need to create more ambitious climate plans. These plans need to be matched by nationally driven roadmaps for financing the just transition. Work is underway in India and South Africa to set out what these roadmaps could contain. Increased flows of both international public and private sector finance to developing countries will be essential, not only to speed up the transition to net zero and strengthen resilience to physical climate shocks, but also to ensure that fundamental social imperatives are addressed through a just transition. If the EU needs a €150bn mechanism to deliver a just transition in Europe, how much is required for the developing world? •

The views in this commentary are those of the author and do not necessarily represent those of the Grantham Research Institute.

A greener world is a shared responsibility

Francisco G Dakila, Jr, deputy governor, monetary and economics sector, Bangko Sentral ng Pilipinas, explains the urgency of mitigating climate change in the Philippine financial system.

THE need to achieve global climate stability is nowhere more felt than in the Philippines, which is situated in the Pacific Ring of Fire and typhoon belt. The country must respond and act fast to contribute to halting climate change and to mitigate its effects on Filipinos.

There needs to be a just transition to net zero, though this makes stemming the effects of climate change more challenging. With emphasis on environmental sustainability, a just transition seeks meaningful changes across labour markets, global trade, capital-intensive technologies and the services sector. Emerging markets may be hard put to pursue a just transition due to cost, technical and political considerations. It requires stronger national commitments that are complemented by robust international co-operation.

The Bangko Sentral ng Pilipinas is paving the way for the financial system in the Philippines to adopt sustainable development principles and encourage investment in activities that advance climate-resilient, green and sustainable growth. The BSP has adopted a two-pronged approach: first, increasing capacity building and awareness initiatives; and second, mainstreaming environmental, social and governance principles.

On 29 April 2020, the BSP issued a Sustainable Finance Framework. It provides for the integration of sustainable principles covering environmental and social risk areas in corporate governance and risk management frameworks as well as in the strategic objectives and operations of banks. This framework is essential for further advancing local banks' involvement in green finance. It enables and encourages them to issue green or sustainability bonds to fund and refinance renewable energy and energy efficient projects, green buildings and other green assets. Recent data show that Philippine companies have issued 35% (or $4.2bn) of the Association of South East Asian Nations' green, social and sustainability bonds, worth $12bn in total.

'Recent data show that Philippine companies have issued 35% (or $4.2bn) of the ASEAN green, social and sustainability bonds, worth $12bn in total.'

As an inflation targeting central bank, the BSP recognises the effects of climate on monetary policy. Impacts of extreme weather conditions, especially on the agriculture sector, are incorporated in policy-making through quantifying the effects of such conditions on the economy. Moreover, weather disturbances may also heighten credit risks that may impair the transmission channel.

The BSP makes sure it practices what it preaches. The BSP has embarked on its Sustainable Central Banking programme, which forms part of the BSP Strategy Map for 2020-23. This programme sets milestones, plans and strategies for the adoption of sustainability principles in key BSP operations and functions. As part of the BSP's sustainable investment and reserves management, we have invested $350m in the Bank for International Settlements' green bond fund.

Promoting a greener and cleaner world is a shared responsibility. The BSP has joined with government agencies and private entities within the Philippines and across the globe to promote sustainability initiatives. Such engagements include the International Finance Corporation-supported Sustainable Banking Network, the Task Force on the Roles of ASEAN Central Banks in Managing Climate and Environment-related Risks and the Central Banks and Supervisors Network for Greening the Financial System.

The Asian Development Bank's Green Infrastructure Investment Opportunities: Philippines 2020 Report has recognised the Philippine government's efforts in promoting sustainable finance. It specifically cites the BSP's efforts and leadership in promoting sustainable finance and green banking initiatives.

Supporting sustainable finance is an endeavour that central banks can credibly undertake to help the transition to a low-carbon economy. Climate change has begun to affect every country. Time is ticking and we are already seeing the effects of climate change with increasing global temperature, rising sea levels, reduction of polar ice caps and even the risk of pandemics. This is one battle we cannot afford to lose. •

Climate change is a green swan

OMFIF's Danae Kyriakopoulou, chief economist and director of research, spoke to Luiz Awazu Pereira da Silva, deputy general manager, Bank for International Settlements, about the crucial role of central banks and global coordination in combatting climate change.

Danae Kyriakopoulou: The transition to a low-carbon economy risks financial instability through 'stranded assets', but also economic prosperity because of 'stranded jobs' in carbon-intensive sectors. Do you see a role for central banks in addressing the impact of climate change on the financial system and on the real economy?

Luiz Awazu Pereira da Silva: Climate change might trigger another 'Minsky' destructive moment for finance. But we could also make it a Schumpeterian creative moment, an historic chance to change. Finance is key. It played a crucial role during the 19th century, fostering the technological transformation that led to the Industrial Revolution. It could play a similar role for the 21st century transition to net zero, combining progress in both green and digital technologies.

The transition to net zero entails physical and transition risks to financial stability and to various sectors of the economy. But it should also be seen as an incredible opportunity for sustainable growth and a green recovery from Covid-19. We will need vast amounts of investments in new green infrastructure, alternative energy sources, new research and development and green cities. About 50% of the technologies needed for a successful energy transition by 2050 are only at prototype stage. All this will need financing and quickly since we are running out of our maximum carbon budget.

Central banks are aware that there is no single agent in the economy nor one unique policy instrument that can solve global warming. They are supporting green finance and playing their role within their mandates for ensuring price and financial stability. They are raising awareness about the new type of systemic risk represented by climate change, providing new models, scenarios and guidance about climate risks and coordinating with the private sector to enable a smooth transition to net zero.

> 'Central banks and supervisors are doing their part, but they cannot be a substitute for what other policy-makers can do in their respective areas.'

DK: Many advanced economies have been on the post-peak of the carbon emissions slope for some time in their journey towards net zero. For emerging markets, the slope is much steeper. How can we balance the need for common global goals, metrics and benchmarks with understanding different contexts?

LAPdS: At BIS, we coined the term 'green swan' to characterise this new type of systemic risk. It is inspired by the concept of 'black swan', coined by Nassim Nicholas Taleb during the 2008 financial crisis for rare, unpredictable and catastrophic events. However, a green swan is a certainty, not a rare event if we do not act. Science says global warming is certain to happen with our current emissions of greenhouse gases. Climate change will unleash cascading, damaging, non-linear forces that interact with each other and threaten human life. Covid-19 is related to deforestation and loss of biodiversity. It is a tragic prediction for both advanced and emerging economies if we do nothing: sudden economic and financial interruption, large supply and demand shocks, forced mass migration and deep disruption of our societies.

The effects of climate change will be more severe in poor countries and for poor households in rich countries. There are important redistributive consequences of climate change and the policies to address it. That is because poor countries and poor people in rich countries have less capacity to mitigate risk and to protect themselves from increasingly frequent extreme weather events such as hurricanes and wildfires.

That is why climate change needs to be addressed in a coordinated way, at global and local level. Because there is no 'silver bullet', we need better coordination between public and private sectors, within and between public authorities (including members of the Central Banks and Supervisors Network for Greening the Financial System) and between countries through multilateral, regional and institutional arrangements.

DK: Besides global and local coordination, what is required to fight climate change? What policy tools are needed to design a transition that accounts for this?

LAPdS: Coordination of countries,

'Covid-19 is a tragic prediction for both advanced and emerging economies if we do nothing: sudden economic and financial interruption, large supply and demand shocks, forced mass migration and deep disruption of our societies.'

governments, agents and civil society will begin moving us towards sustainable development, speed up the implementation of environment-friendly policies and reinforce our approaches to climate and environmental risks. But coordination needs to encapsulate and use multiple instruments.

We need new rules and regulations. Carbon pricing is paramount, but we need also prudential rules, transparent (many say mandatory) disclosure requirements, monitoring of climate risk exposure, accurate measurement of carbon emissions by firms, proper accounting standards, a homogeneous global green taxonomy, carbon budgets with decreasing levels of emissions up to 2050 and macroeconomic frameworks incorporating climate risks. Central banks and supervisors are doing their part, but they cannot be a substitute for what other policy-makers can do in their respective areas. We need to act now because it is too risky to simply wait and see.

We also need practical, concrete steps for the financial sector. Some are being considered: green financing, mobilising capital markets, designing portfolios aligned with the Paris agreement, long-term venture capital for new R&D, technologies for carbon capture and resources to protect biodiversity and health.

DK: Thinking more broadly about the political economy of the transition, what needs to be done to enhance the synergies and balance between private sector and official sector action for a successful transition?

LAPdS: For the climate-related transition, countries need to work together and use the global governance system of multilateral dialogue and international institutions to make a difference.

There is increasing goodwill by governments committing to net zero. There are public sector coalitions such as the NGFS, the Coalition of Finance Ministers for Climate Action and the alliance of development banks in the Finance in Common Summit. There are also coalitions of private sector organisations with up to $70tn of assets under management, including Climate Action 100+ and Net Zero Asset Owner Alliance.

There has been a strong coordinated counter-cyclical response to Covid-19 by central banks and treasuries. There are ambitious recovery plans with sustainability angles in the US, Europe and Asia. There has been fast scientific progress on vaccine development. Therefore, we do see reason for hope even if sometimes there is insufficient coordination in public health responses across countries, especially the poor ones, and risks of regulatory fragmentation with inconsistent definitions of environmental, social and governance criteria.

This year offers opportunities with a renewed and rare alignment of goodwill on climate change and nature: COP15 on biodiversity, COP26 on climate and committed G7 and G20 presidencies. There will also be mounting pressure from civil society and investors that will request, irrespective of regulatory progress, more transparency and disclosure of the carbon footprint of their investments. It is time perhaps to embed all these important voluntary approaches into the formal international architecture to truly achieve effective international coordination. •

How to make transition finance work

We need to combine approaches that consider different regions, sectors and pathways, writes Aayush Tandon, policy analyst, green finance and investment, OECD.

SUCCESSFULLY delivering the goals of the Paris agreement requires using multiple approaches to decarbonisation. As we enter the decade for delivery, there is an urgent need to not only scale up zero or low-emitting technologies and businesses, but also support emission reduction efforts in high-emitting and hard-to-abate sectors.

Many governments and market participants have cautioned against focusing solely on green activities and excluding sectors that, though carbon-intensive, are key to economic development in certain countries and regions. Some argue that an understanding of sustainable finance that qualifies only zero or low-emission technologies and businesses could exclude large areas of the economy from capital markets. In this context, 'transition finance' is gaining traction among governments and market participants.

There has been a proliferation of sustainable finance taxonomies and definitions. A report by the Organisation for Economic Co-operation and Development points to a rapidly diversifying landscape for such definitions, and the risk of global fragmentation that may hinder the flow of capital. A similar trend can be observed in transition finance. A range of taxonomies, principles and guidance have been proposed by governments, investors and industry associations to channel capital towards high-emitting sectors. Financial markets have also seen the emergence of 'transition bonds'.

Despite successes in expanding the sustainable debt market, research suggests labelled bonds may not be contributing to climate mitigation objectives as much as hoped. Green bonds have had little impact on lowering emissions at corporate level. With rising interest in transition finance it is important to identify the market gap such instruments seek to fill, their distinguishing features, drivers of return and pricing structures to ensure they make a tangible contribution to the low-carbon transition.

The focus on transition-themed instruments and definitions in a whole-of-economy approach to the low-carbon transition is a welcome development. However, outstanding questions must be addressed to ensure transparency, impact and coherent market development. For instance, what are transition instruments adding? Is there need for another label? Which sectors and technologies should qualify for such finance and why? And which transition pathway(s) should be used as a benchmark?

'Different socio-economic priorities and domestic capabilities will dictate the specifics of the low-carbon transition in different countries.'

Transforming economies to low- and net-zero carbon is an unprecedented challenge. Different socio-economic priorities and domestic capabilities will dictate the specifics of the low-carbon transition in different countries. This implies variance in transition pathways among countries, posing challenges for capital allocation and portfolio alignment especially by investors with assets spread across geographies.

Pathways are central to transition instruments. Transition bonds are typically structured as vanilla fixed-coupon or key performance indicator-linked securities. In either case, commitment to a transition trajectory by the issuer is a prerequisite. However, more guidance and consensus is required on what a credible corporate transition strategy looks like, and how to translate national and regional strategies credibly at issuer level.

As countries and regions devise their transition pathways, they need to consider international climate and development commitments, the impact of the transition on societal inequalities, environmental issues beyond emission reduction and the functioning of the system as a whole.

Given the scale and pace of emission reduction needed to achieve global climate and development objectives, it is crucial at this initial stage to find a common understanding of the transition process. To this end, the OECD has launched a project called Low-carbon Transition Finance: Emerging Approaches, Needs and Ways Forward.

The project will run from 2021-22 and include analytical deliverables and stakeholder events. The first output involves a stocktake of transition finance-related taxonomies, principles, guidance and financial instruments. The paper, to be published by summer 2021, will identify similarities and differences in approaches to determine the core characteristics of transition finance. It will form the basis of a series of discussions and deliverables to drive consensus and convergence. •

Ensuring a just transition for SMEs in Asia

Peggy Pui Kei Tse, chief strategy officer, Good City Foundation, explains what a just transition to a green economy looks like and why we need to pursue it for developing markets.

THERE are two reasons for pursuing a just transition to a green economy. First, we have to proactively address the costs of undertaking the most ambitious climate agenda in history and learn from previous failures to mitigate climate impacts.

Second, the concept of a just transition has evolved into something larger and more complex. In the 1990s, trade unions in North America urged labour support programmes for those who lost jobs due to environmental protection policies. In 2021, a just transition will depend on how people handle climate change at a global scale, in conjunction with a post-pandemic economy, new international dynamics and a technology revolution.

An important question is whether small and medium-sized enterprises have a practical and equitable pathway towards a low-carbon and resilient future. SMEs are the backbone of Asia's economy. According to the Asian Development Bank, they make up more than 96% of all businesses and provide two-thirds of private sector jobs on the continent. Most SMEs engage in wholesale, retail, food and agribusiness, light manufacturing and services sectors.

Most cities in Asia do not have adequate tools to help SMEs through a just transition, although SMEs have been a key driver of local economic growth, particularly for many developing countries. Given the significance of this group of businesses, it is unwise to forgo the opportunity to engage SMEs in the transition conversation.

Good City Foundation has adopted a two-step approach to facilitate a just transition for SMEs. To start, we spend extensive time and resources understanding the local context. Many business owners in Asia are aware of the sustainability challenges the world faces today. However, there is severe disconnect between the global narrative and nuanced local issues that require specific solutions to resolve.

To bridge the gap, the next step is to connect local governments and SMEs through projects and partnerships, such as urban renewal and zone developments. Identifying a tangible project that can put the conversation into context is very useful for helping governments and SMEs envision what a just transition actually looks like. The mutual exchange of insights supports strategic alignment of both parties and feasibility assessment of transition options.

Good City Foundation recognises SMEs are often committed to taking positive climate actions as they can only thrive when the local habitat thrives. Local sustainability is a core interest of SMEs in Asia. On the other hand, we should not forget how vulnerable SMEs are: they face extremely intense competition, have disproportionately few resources and operate on very thin margins.

Therefore, governments need to create sufficient boosters and safeguards (such as re-skilling, access to financing and transfer payment schemes) for this group. At present, our world's climate transition may seem to have dimmer prospects than before. But when demand, trade and investment recover, SMEs will be motivated to help bring climate change mitigation back on track or even make up for lost time.

A transition is rarely smooth or clear. It is often bumpy and difficult. Nonetheless, establishing good principles and a reasonable framework to facilitate a just transition remains a critical task for us because this will not be our last transition. •

'According to the Asian Development Bank, SMEs make up more than 96% of all businesses and provide two-thirds of private sector jobs on the continent.'

Covid-19 could accelerate energy transition

The transition to net zero must include workers and industries, write Philip Gass, lead, transitions, energy programme, and Lourdes Sanchez, senior policy adviser and lead, Indonesia, International Institute for Sustainable Development.

TO achieve government net-zero pledges, the energy sectors need to be transformed. The transition to a greener future is going to affect our economies and societies, and impacts will be felt by industries, workers and communities. To mitigate risks and present opportunities for all, these groups need to partner with governments in developing solutions and achieving net zero.

This is possible through the concept of a just transition – an idea that has developed over time, pioneered by labour organisations. The International Labour Organization defines it as contributing to 'the goals of decent work for all, social inclusion and the eradication of poverty', as well as 'an environmentally sustainable economy'.

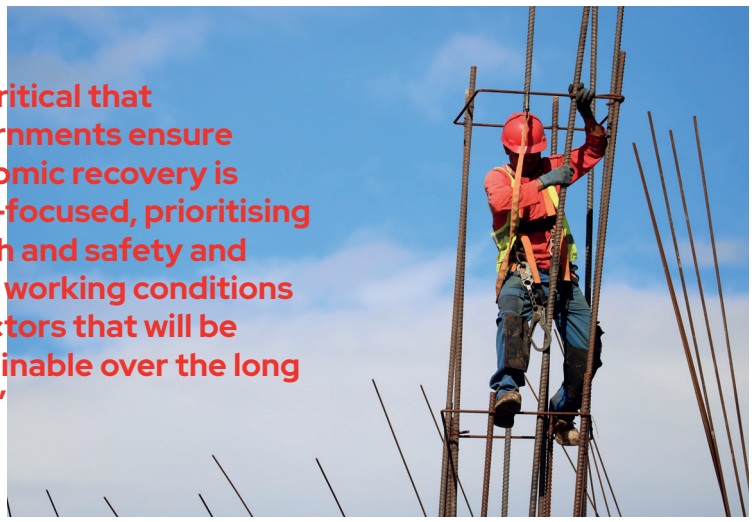
Just transitions have two main elements: first, social dialogue that includes representatives of governments, industries and workers to raise concerns, identify priorities and build broad support for policies. Second, meaningful and strong engagement with non-tripartite stakeholders affected by the transition. This may include civil society groups, consumer associations, local communities and non-governmental organisations who will be affected by a changing energy sector. It is critical to recognise that energy transitions are strongly driven by local dynamics in regions where transition impacts are felt most directly.

The recovery from the Covid-19 pandemic and the public funds injected into the economy will have an important impact on the energy transition, but also on employers and workers. In many cases, the pandemic has accelerated trends or added strain to sectors where jobs are being impacted. Since the onset of Covid-19, there have been increasing concerns around work security and managing the outsized impacts of economic disruption on vulnerable groups, including families, workers and young people.

It is therefore critical that governments ensure economic recovery is work-focused, prioritising health and safety and good working conditions in sectors that will be sustainable over the long term. Active employment and labour market policies, including the creation of alternative jobs in other sectors aligned with net-zero plans, support for skills development, retraining for workers and strong social protection/social insurance services are all essential to maintaining livelihoods. Measures to de-risk investment opportunities in green sectors and develop infrastructure that supports clean energy (such as electric vehicle charging facilities) are also essential.

Governments should pursue a just energy transition, assessing potential impacts and embedding its principles across sectors and policies. Delaying the inevitable energy transition and prolonging the life of sectors that are not viable in the long term (for example, through inefficient subsidies) could have significant social, economic and environmental consequences.

Above all, conversations about diversification within the energy sector must occur through engagement with relevant stakeholders so that employment, social and environmental priorities are fully considered in industrial policy. The energy transition, which starts with Covid-19 recovery plans, needs a worker-focused approach that contributes to the reduction of inequality. Solutions that are jointly developed and implemented are most likely to be broadly supported and succeed in guiding us to a low-carbon, resilient economy. •



'It is critical that governments ensure economic recovery is work-focused, prioritising health and safety and good working conditions in sectors that will be sustainable over the long term.'

The expensive cost of inaction

Matt Lobner, head of international markets, Asia, HSBC, explains why Asia and other emerging markets must be involved in the transition to a net-zero global economy.

TRANSITIONING to a net-zero global economy is going to be expensive: the price is rising as the measures required to limit global warming to 1.5°C become more urgent and more extensive. But the cost of not transitioning will be even higher.

Capital is already shifting to favour green solutions as society demands action. The shift will happen with or without government support. Banks and other financial institutions have a critical role to play in channelling the funds to pay for the global economic transition to net zero.

Years of feet-dragging have added to the urgency of addressing global warming. If we had wanted to limit global warming to 1.5°C 10 years ago, we would have had to cut global emissions by 3.3% each year. Today, we need to cut emissions by 7.6% each year to hit that target, according to the United Nations Environment Programme's Emissions Gap Report 2019. There is little consensus on how much it will cost to keep climate change in check beyond that it will be expensive. The Intergovernmental Panel on Climate Change calculated a figure of just under $3tn a year to limit warming to under 2°C, but other estimates vary from $600bn to $5tn a year.

Even at the low end, these sums are barely within reach of even the richest governments, let alone being accessible to emerging markets where the impact of financing reductions in emissions and other environmental degradation is greatest.

Over the past decade there has been a sea-change in attitudes to paying to limit climate change. Now, both the money and investor appetite is there. Banks and other financial institutions are the link between capital and sustainable investment. The average green bond issue last year was oversubscribed 5.7 times, and the largest exchange-traded fund launch so far this year was Blackrock's $1.25bn US Carbon Transition Readiness Fund. But there are stumbling blocks to green finance that banks cannot solve on their own. Investors struggle to systematically price risk and managers are increasingly wary of falling victim to 'greenwashing' – the practice of dishonestly describing environmentally destructive projects as sustainable to access the pool of green investment capital.

The solution is a transparent system that defines and rates environmental risk in the same way that agencies like Moody's and Standard & Poors categorise and rate financial risk.

Work is being done on creating these systems – or 'taxonomies' – around the world. The European Union led the way, but other jurisdictions are also developing guidelines, including the Association of South East Asian Nations, Hong Kong and elsewhere.

It is important that Asia has a significant voice in this process. The continent is not only going to drive global economic growth and innovation in coming years, it has also been responsible for 87% of the incremental growth in total greenhouse gas emissions over the past 30 years. It is vital that the taxonomies are broad and flexible enough to accommodate countries at each stage of development while preventing abuse by more privileged nations. They must acknowledge that emerging markets may not have the resources to implement best practice solutions immediately, but if the world is to achieve net zero by 2050, they need to be an integral part of the green finance ecosystem to improve their sustainability performance.

Once these are in place, banks can fulfil their role of turning savings into investments. They can recycle the excess capital of both developed economies and the growing wealth in emerging economies, particularly in Asia, into a sustainable future for everyone. •

'It is vital that the taxonomies are broad and flexible enough to accommodate countries at each stage of development while preventing abuse by more privileged nations.'

A marathon, not a sprint

Henner Asche, deputy director general markets, Deutsche Bundesbank, speaks to OMFIF's Danae Kyriakopoulou, chief economist and director of research, about what central banks can do to help ensure a just transition to a low-carbon economy.

Danae Kyriakopoulou: Central banks' involvement in the climate agenda has so far been aimed at safeguarding financial stability from climate-related risks. But some also have responsibilities as public institutions to support the economic policies of their respective governments. How do you see the evolution of central banks' thinking in this area and how can they support the financial sector in making the best use of opportunities?

Henner Asche: Climate change affects all aspects of monetary policy: output and inflation, long-term interest rates and policy transmission. A comprehensive analysis, combined with in-depth debate, is crucial for a better understanding of how climate-related risks interact with our primary objective of price stability, and how we may adequately incorporate them into our monetary policy framework.

These debates are part of our monetary policy strategy review. The discussions are still ongoing in the Governing Council, and we expect to conclude them in the second half of this year. It would be premature to draw any firm conclusions, but climate issues will be more prominent in our future framework.

Central banks clearly need to play their role in the global efforts to curb climate change. We cannot assume the role of governments, but neither can we be mere bystanders in the transition towards a carbon-neutral economy. We are publicly accountable institutions, and we serve our societies. Therefore, it is our responsibility to take up that challenge that will deeply affect all of us.

To this end, we are already taking concrete first steps. The Bundesbank is promoting the disclosure of climate-related risks. From mid-2022, we will disclose climate-related risks for our non-monetary policy portfolio. In addition, we aim to foster market transparency more broadly. In fact, the Eurosystem should get to a point where, for monetary policy purposes, it only purchases securities or accepts them as collateral if their issuers meet certain climate-related reporting obligations. Moreover, we are exploring how climate-related information could feed into our own internal credit risk assessment.

> 'Central banks are already contributing to reaching net zero by fulfilling their core tasks: preserving price stability, ensuring financial stability and supervising financial intermediaries.'

DK: What role can central banks play in the wider financial ecosystem in scaling up green finance? Some institutions such as the European Central Bank have developed or enhanced targeted lending instruments in response to the crisis. Can some of these be 'greened'?

HA: The option to introduce some sort of green targeted lending would entail adjustments to the pricing of lending facilities by making it conditional on climate-related features in the counterparty's future lending, relative to a benchmark. Such features could be a transformation or decarbonisation strategy, for instance.

We need to keep in mind, however, that there are considerable differences in terms of mandates and institutional set-ups across central banks all over the world. Green targeted lending – by offering lower interest rates to banks with larger shares of green lending – would come close to directly steering the credit provision. That might be more suitable for institutions whose role is comparable to that of promotional banks or agencies, like the KfW Group in Germany.

For central banks with full independence, introducing a targeted green lending scheme could be difficult to reconcile with level playing field considerations.

With regard to the role of promotional banks, in Germany the KfW serves as the primary federal promotional bank. It was founded in the post-war years, with the explicit aim to support public policy objectives through dedicated funding, like infrastructure and housing initiatives on a large scale. In that context, the KfW was set up to ensure a clear line between the role of the central bank and the role of a promotional entity.

DK: The Eurosystem has been criticised for carbon bias in its asset purchase portfolio. How does this stand against its objective to address climate risks and what have been some of the challenges faced in decarbonising monetary policy?

HA: Climate change also has a

'When it comes to the question of a 'just transition', politicians have the most effective and efficient instruments at their disposal to spur such transition of our economies in a targeted manner. Carbon taxes or emission certificates could be powerful tools.'

bearing on the financial risks embodied in our portfolios, both for monetary policy and non-monetary policy purposes. In this regard, the EU taxonomy for sustainable activities is a welcome step in the right direction, as it is necessary for a proper understanding of the risks in these portfolios.

Regardless of regulatory developments in that field, the claim of a carbon bias in our private sector monetary policy portfolios, in particular in the corporate sector purchase programme, has been discussed in the last few months.

Let me stress that we conduct the purchases in the CSPP with the aim of avoiding price distortions of bonds of similar characteristics coming from different issuers or market segments. Purchases are orientated towards a benchmark, where issuers are weighted according to the market capitalisation of their outstanding (eligible) bonds. This allows for a level playing field.

So far, we have no mandate to systematically overweight 'green' issuers or industries. At the same time, we do not have a carbon bias either: the actual share of green bonds in our CSPP portfolio is very close to the respective share in the eligible universe.

DK: The Bundesbank is leading the Central Banks and Supervisors Network for Greening the Financial System's workstream in scaling up green finance. This is still a very small segment of the market with investors frequently complaining about lack of asset supply. The ECB already holds around a fifth of eligible green bonds, but there are pressures on it to decarbonise and green its portfolio further. Some of these actions may have negative side effects –at least in the short term – for employment in certain sectors. How should central banks consider these issues around a 'just transition' when designing climate policies?

HA: When it comes to the question of a 'just transition', politicians have the most effective and efficient instruments at their disposal to spur such transition of our economies in a targeted manner. Carbon taxes or emission certificates could be powerful tools.

At the same time, central banks can make an important contribution in the fight against climate change as well. Climate protection is certainly one of the most pressing tasks of our time, and we must act quickly.

Central banks are already contributing to reaching net zero by fulfilling their core tasks: preserving price stability, ensuring financial stability and supervising financial intermediaries. These three pillars of our work are essential preconditions for a just transition since a transformation of the economy will require considerable long-term investments. This requires planning certainty for companies and governments, reliable information on prices and stable financial markets. A more volatile inflation rate makes it more difficult to extract price signals. Price signals for carbon emissions can only work if market participants notice them. In a nutshell, central banks can make price signals effective by preserving price stability.

Having said that, central banks can and should do more. That is our conviction and we are already stepping up our efforts. Ahead of us lies a marathon rather than a sprint. •

FORTHCOMING MEETINGS

omfif.org/spi

9 Jun: The role of central banks in greening portfolios and sustainable investment

Benoit Mojon, head of economic analysis, Bank for International Settlements, discusses the role of central banks in driving sustainable investing and portfolio transition through green monetary policy. Other key points of discussion will include transition credibility, brown portfolio exclusion and incentivising shareholders.

16 Jun: Developing green bankable projects in capital markets: Driving greener investment

Kosintr Puongsophol, financial sector specialist, economic research and regional co-operation department, Asian Development Bank, and Paneeya Nitiwanakun, assistant director, bond department, Securities and Exchange Commission Thailand, discuss how to identify and grow bankable projects in capital markets. They explore the tools required, the impact on portfolios and the challenges and opportunities for central banks.

24 Jun: Fed week, day 4 – Rebuilding sustainably and equitably

Following a year of unparalleled disruption, loose monetary and fiscal policies have become the new normal and many long-term economic and societal changes remain uncertain. OMFIF and the Federal Reserve Bank of Philadelphia are hosting a series of seminars to discuss the Federal Reserve's priorities. Day four will include discussions on how three crises – health, economic and social – are converging into one difficult moment in American history, protecting the economically vulnerable communities that are least equipped to cope and managing the physical risk climate change poses to the US financial infrastructure.

25 Jun: Bridging the data gaps: An update on the NGFS workstream

Fabio Natalucci, deputy director, monetary and capital markets department, International Monetary Fund, and Patrick Amis, director general, European Central Bank, are the co-chairs of the workstream on bridging the data gaps, set up by the Central Banks and Supervisors Network for Greening the Financial System. They discuss the latest workstream report, key findings of the research and latest developments on data usage and availability for sustainable finance.

30 Jun: Designing policies for efficient, inclusive and sustainable housing

Luiz de Mello, director of the policy studies branch, Organisation for Economic Co-operation and Development, discusses the recent OECD report examining how to design policies for efficient, inclusive and sustainable housing. Key topics of discussion will include how to build housing resilience, promoting affordability and driving wealth redistribution in housing.

8 July: Channelling capital towards renewable energy technology

This panel will examine the policies and frameworks required to channel capital towards renewable energy technology. Key topics will include the role of taxonomies and carbon pricing, the requirements for developing a pipeline of investment grade projects and the opportunities and challenges involved, as well as the risks of transitioning to a low-carbon economy versus remaining stagnant. Panellists will also examine the level of capital and asset allocation required to achieve the 2030 targets.

14 July: Transition taxonomy and new capital markets

Robert Youngman, principal policy analyst, Organisation for Economic Co-operation and Development Environment Directorate, and Irene Espinosa-Cantellano, deputy governor, Banco de México, discuss transition taxonomy in carbon-heavy jurisdictions. Topics will include developing standards, credit solutions, transitioning to greener capital markets and the risks, challenges and opportunities involved.

22 July: Circular economy: Challenging traditional monetary finance models

In this panel discussion, speakers will discuss the role that the circular economy can play in mitigating climate change and driving just transition to net zero. Key points of discussion will include asset usage and challenging traditional monetary finance models.

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