“From 1 to 17?”
Lecture Frank Elderson at UNEP Finance Initiative (FI) Positive Impact Finance
Amsterdam, 23 November 2017

If you would take a closer look at all the things done, perhaps we can be a bit more critical. So far, most of our climate-risk related work is focused on climate-related risks. We’ve looked at how the energy transition could impact the economy, we’ve looked at how the financial sector is at risk from climate change and the energy transition. But being critical, from our supervisory mandate we’re mostly just focusing on climate risks. But isn’t climate just one of the SDGs? Aren’t there 16 other SDGs? And couldn’t each of these SDGs have physical or transition risks for our economy and therefore for our financial sector?

The Principles and the Manifesto pose serious questions for serious times. Questions that we also ask ourselves and that we struggle to answer.

Good afternoon everyone, and welcome to DNB.
It’s a pleasure for us to host UNEP Finance Initiative (FI) today and its work on Positive Impact Finance. As many of you know, DNB has been quite active on the topic of sustainable finance. Hosting a third party event however is not something we very often do. The main reason is that Positive Impact Finance is unambiguously ambitious and we recognize some of that trait in our own character.

Challenges…
Our societies are facing tremendous challenges, and are facing a lot of them at the same time. In terms of our climate; our world is now already more than one degree warmer than it was before the industrial era. For one thing, this has caused the amount and the severity of storms and floods to increase, worldwide often with deadly result, as we have seen far too often this year.

But climate is just one challenge: Nearly 2 billion people worldwide do not have access to clean drinking water. 700 million people are living under the poverty line of almost 2 dollars a day. And in Sub-Saharan Africa, four in five people are undernourished and 45% of children die before they are 5 years old because of malnutrition.

The good news is that we have international agreements targeting these issues. We have the Sustainable Development Goals and the Paris Agreements. Wouldn’t it be wonderful if just like a multinational, the world would have a clear strategy?

Well, not only does the world have such a strategy, we, increasingly, see many governments, business and investors taking steps to pursue it and to tackle these challenges.

But we also need to be realistic: we are a long way from achieving the goals. Let's take a look at China for example. Sure, it's the green energy and green finance power house of today. It's the world's leading producer of solar and wind power, and it's the largest green bond market in the world.

But it also uses and produces 50% of all the coal burnt globally. It's responsible for 25% percent of all daily energy consumption. And CO2 emissions are rising worldwide again, mostly because of China. So the challenges remain.

Funding the transition
And what's more all of these challenges have a financing element. For climate for example, it is estimated that an additional 1.5 trillion dollars are needed annually to finance the required investments. And for all of the SDGs combined, an estimated 5-7 trillion dollars are needed annually until 2030.

As the UNEP FI Manifesto rightly states, all of the current initiatives together, however impressive, will most likely not be enough to finance the SDG investment gap. And so, what is needed, according to the Manifesto, is a financial sector that jointly considers the three pillars of sustainable development: economic, environmental and social.

And that any investment should deliver a positive contribution to one of these pillars, once any potential negative impacts to the other pillars have been identified and mitigated.

Eric Usher – and we are very proud to welcome him here on our premises - will explain the thinking behind UNEP FI's conclusion that in their assessment a transition to a new finance paradigm is required. That's right, ladies and gentleman, a new paradigm no less! Talking about ambition…

Getting to a financial sector that bases itself on an appraisal of both positive and negative impacts will not be easy, I'm afraid. In fact, it´ll be hard. And if it were to be done, it would require courage, practice and perseverance. And there will probably be moments where you might simply think: this is in fact impossible; there is simply no way to achieve this, so why am I even hurting my brain over this?

Dutch initiatives
Well, should that be the case, please allow me to share two considerations with you that might make your struggle more bearable.

One: I'd dare to say, somewhat chauvinistically, that The Netherlands is among the frontrunners in the world in terms of incorporating sustainability considerations in finance.

Many of our financial institutions assess ESG factors in their investment decisions. Based on a survey we recently conducted, 17 out 28 surveyed financial institutions measure the carbon footprint of at least a part of their balance sheet. And 9 of those have even committed to lowering that carbon footprint. Furthermore, our banks have collectively issued a climate statement, an SDG-dialogue document, and an international covenant on human rights in project finance. They are key players in the Equator Principles, in carbon disclosure and divestment initiatives. Many of our insurers and pension funds, bring up ESG-issues in investor calls, and have ESG-engagement strategies. And three out of the top 10 of most sustainable companies worldwide according to the Canadian Investment advisor Corporate Knights are Dutch.

In short, the Dutch are rather active indeed on this issue and we've already in fact come quite far. And we're probably a lot further than where people thought we would be 5 or 10 years ago.

So, whenever you feel the challenge is insurmountable, just think back to where we stood 10 or, if you go through a moment of particular pessimism, 20 years ago, and where we stand today. Hopefully the realization of how far we've progressed already, will give you enough energy to keep going.

DNB initiatives
The second consideration - because I promised you two - is that you are not alone in facing this challenge. Of course, there are all the signatories to the principles of this manifesto. But actually, your central bank and supervisor faces a similar challenge.

You see, DNB, as I'm sure many of you know, has been quite active on the topic of climate risks: both on physical risks stemming from climate change, as well as on transition risks, stemming from legislation or market developments.

About 2 years ago, we issued a report called Time for Transition. In this report we investigated the potential impact of the energy transition on the Dutch economy, and we noted that the upcoming transition is in fact one of the biggest medium to long term challenges to our economy and therefore for our financial sector.

And a few weeks ago we published a report called Waterproof?, in which we took a closer look at climate risks in the Dutch financial sector. In this report, we concluded that in both a 1.5 degrees and 3.5 degrees scenario, climate-related damages are expected to go up due to an increase in the frequency and intensity of severe weather events. This means that insurance premiums may have to go up and that insurers may need to hold more capital, as they hold capital for severe events. We also found that models currently being used by insurers to predict damages do not adequately take climate change trends into account.

In terms of the energy transition, we warned of risks stemming from new sustainability legislation for offices. The Dutch government requires office buildings to have a minimum energy label of C as of 2023. This means that all office buildings that don't meet this requirement now, have five years to reach the required level, or their cash flows will dry up. Our financial sector finances large chunks of the real estate sector. When cash flows dry up, that will jeopardize the value of these loans.
So how big is the problem? We found that on average 46% of bank loans to commercial real estate parties, has an energy label of less than C, representing some 6 bn euros. These loans run serious risks the coming years, and banks need to manage this risk. In doing so, by the way, they will discover, indeed they of course already have, that there are also ample and sound business opportunities to help their clients meet these legislative deadlines, thus creating a win win situation for business and climate.

But that's not all. As a follow up to this work, we are right now developing both physical and transition related stress tests. And we hope to present the results of the physical stress test in the coming few months.

We've also done some work on the broader question of sustainable finance. About a year ago we published a report on responsible investing in the pension sector. This was based on a requirement in Dutch law for pension funds to be transparent as to whether and how pension funds take ESG factors into account. We assessed whether indeed all pension funds included their ESG investment policy in their annual report, and we shared the good practices that we saw.

Last but not least, using our convening power, we've founded a national Platform for Sustainable Finance, which brings together our government, supervisors and industry representatives from the entire financial sector. The aim of this platform is to promote and encourage a dialogue on sustainable finance in the financial sector. In addition, the Platform also allows for financial institutions to form cross-sectoral working groups to tackle existing problems. One of these working groups, called the Platform Carbon Accounting Financials, or PCAF, has developed a methodology on how to measure the carbon footprint of six different asset classes. They will launch this report soon.

Another working group has worked on SDG Impact Measurement. It developed, and recently launched its report, and I'm very proud that they're here.

So we've been quite active as you can see. And as a central bank and prudential supervisor, we're actually rather proud of all the work we've done. And we'd even dare to say that we are among the frontrunners in Europe and perhaps even worldwide.

A critical look at all initiatives…
But if you take a closer look at the things we've done, perhaps we can also be a bit more critical. So far, most of our work is focused on climate-related risks. We've looked at how the energy transition could impact the economy, we've looked at how the financial sector is at risk from climate change and the energy transition.

So if we're a bit critical, from our supervisory mandate we're mostly just focusing on climate risks. But isn't climate just one of the SDGs? Aren't there 16 other SDGs? And couldn't each of these SDGs have physical or transition risks for our economy and therefore for our financial sector?

Let's take a look for example at SDG #15, Life on Land. Every year we gain 3.5 billion hectares of desert. And every year we lose 13 million hectares of forest. Biodiversity is also declining at an alarming pace. A recent study done in Germany showed that the average insect population has declines with 75% in the last 30 years.

If governments don't take action to stop the loss of biodiversity, this might for example one day lead to crop failures. And this might not happen slowly, but could perhaps be caused when we reach certain tipping points. If that were to happen, obviously, one of our basic human needs would be jeopardized. But from a financial point of view, agricultural companies might face difficulties, and that might impact banks financing the agriculture sector. And so it might not be too far reaching a thought that is would seem important for such a bank to be aware of potential risks from biodiversity loss.

Or what about SDG #12, sustainable consumption and production? About making sure that we use all natural resources in a sustainable way? What if governments introduce legislation to ensure sustainable use of resources? Unsustainable companies would be relatively hard hit, and their profitability could be at risk. And thus, the financial sector that invested in them through stocks, bonds and loans.

Move from 1 to 17?
In short shouldn't we move our work on sustainability from 1 to 17 SDGs? Couldn't there be more risks than just climate? Need these risks not be managed? Should the prudential supervisor not broaden its focus?

And what about impact? Couldn't we do research into access to finance? Into potential bottlenecks for financing the SDGs? Couldn't DNB have anything to say about striving for impact towards achieving the SDGs? Would that bring us to the fringes of our mandate? Or possibly beyond? The answer is not yet clear.

Fortunately, this is exactly what we will look into in 2018. How do the SDGs fit in our mandate? It won't be easy for us. We don't have an exact answer. It's pioneering. It's challenging. It's a struggle. But it's one we're happy to undertake.

Even doing this, however, we'll probably still fall short of the new paradigm advocated in the Manifesto. Because we would most likely be looking at each of the SDGs separately and assess to what extent they pose risks for the financial sector (both in terms of "physical" and in terms of "transition" risks). To the extent they do, we would squarely be within our mandate. But I know Eric will call for a more far reaching approach. Moving from risk to impact, and looking to all SDG's holistically.

So we have a lot of work to do. A lot of thinking to do, a lot of pioneering to do.

The Principles and the Manifesto pose serious questions for serious times. Questions that we also ask ourselves and that we struggle to answer. So whenever you're feeling like the task ahead of you is insurmountable, perhaps you will find comfort from the fact that your supervisor is struggling just as much as you are.

But we're all struggling in the right direction.