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Banking and sustainability

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The future of the banking industry is a recurring theme in the media. Articles are published daily highlighting the challenges and difficulties banks face. These include most notably the need to tackle the technological challenge and cut costs; the importance of updating the banking business model against a background of lower margins and the emergence of new players; and the possibility of mergers taking place.

Recently adding to this now-classic list is a new feature: the role **the financial sector should play in relation to climate change**.

The social interest and mobilisation stemming from the recent COP25 in Madrid attests to society's growing awareness of the problem of climate change. Much of the regulatory drive in this area is moving in tandem in the public and private sectors, which is a novelty.

Another novelty is the **growing demand that companies disclose information** on the effect that their economic activity has on the climate. Investors, lenders, insurance companies and other interested parties demand this information in order to take investment or institutional collaboration decisions. Increasingly, companies are applying the disclosure standards produced by the *Task Force on Climate-related Financial Disclosures* (TCFD), set up on the initiative of the Financial Stability Board (FSB) and made up entirely of members from the private sector.

Many companies have moved from a **defensive stance**, involving minimum compliance with environmental standards, to **taking up the cause** and analysing how to transform their business model to adapt to the new demands.

There are also initiatives that have been pursued completely outside the sphere of public intervention. This is the case of the so-called "green bonds", created in response to the demand by **private investors prepared to invest ethically and responsibly**. Indeed, this market is wholly underpinned by private standards, such as the *Green Bond Principles* (GBP) published in 2014 by the ICMA (*International Capital Market Association*). Clearly, we can conclude that the **fight against climate change is not led solely from the public sector**. The commitment by all parties - public sector, investors, companies and citizens alike - to these objectives is clear. The potential of this change in terms of growth

and job creation is most considerable. But there will inevitably be adjustments in some sectors, meaning we must ensure that the transition is “fair”.

Admittedly, each actor has a role to play in this global fight and the contribution by the financial sector, which has committed itself to these objectives, is also key. For example, during the Madrid COP25 in December, more than 20 institutions accounting for more than 95% of the financial system signed an **agreement to reduce the carbon footprint in their balance sheets** in line with the Paris agreement.

The transition to a more sustainable economic model involves challenges but also opportunities for the industry.

In terms of opportunities, there is an evident need of financing to cover investments that will enable the transformation of our economy. One recent paradigmatic example is the *European Green Deal*, published by the European Commission in December last year. Its aim is to attain a **“climatically neutral” economy in 2050**, which will entail **mobilising at least €1 trillion** in sustainable investments over the coming decade.

In terms of challenges, banks must assess and measure the effect of these risks on their borrowers, both direct risks (“physical risks”) and those resulting from action taken to promote the transformation of our economy (“transition risks”), integrating them into their management. There is an evident **problem of a lack of data to properly measure these risks**; accordingly, banks should begin to classify their customers in terms of their environmental effect, following the recently approved EU taxonomy.

Let us not forget that **there are also challenges for supervisors**. In the coming years it will be important for the authorities to develop tools, including stress tests, to properly assess these risks from a macro and micro perspective. In this respect, the *Network for Greening the Financial Sector* (NGFS), which brings together over 60 central banks and supervisory authorities and in which the Banco de España is an active participant, is about to publish a manual detailing the different tools banks and supervisors should apply to address this risk.

In sum, both banks and supervisors have a significant role to play in this challenge. **We must respond realistically but also ambitiously**. Unquestionably, the sustainability of banking business rests on the global sustainability of our planet. Let us hope, for everybody’s sake, that we can rise to this collective challenge.