



## **Reclaim Finance – Response to the FSB consultation on the “Supervisory and Regulatory Approaches to Climate-related Risks: Interim Report”**

### **General remarks**

The report somewhat integrates the systemic risk perspective, thus rightly pointing out the risk transfers between different types of financial institutions and assets, and potential spillovers and feedback loops between the financial system and the real economy. Unfortunately, the report fails to accurately grasp the endogenous nature of climate-related risks (see IPCC, “Chapter 15”, *AR6 Report*, 2022). If physical risks remain ill measured – and will always remain difficult to quantify - the current knowledge of the massive impact of climate change on economic activity should drive the FSB to adopt a precautionary approach to climate-risks and to look at the double materiality of these risks (see Hugues Chenet and al, “Developing a precautionary approach to financial policy – from climate to biodiversity”, *Inspire*, 2022). This need is further increased by the massive biodiversity and environmental degradation that could impact a majority of human economic activity (see World Economic Forum, *Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy*, 2020).

The recommendations of the report do not go beyond the recommendations and work launched by various authorities and institutions worldwide in the past few years (for example the NGFS, European Central Bank, Bank of England...). It therefore fails to consider the time dimension of the climate risk problem: by the time supervisors and regulators gathered what they deemed to be sufficient data and methods of measurement, climate-related risks will have increased and could even have reached a systemic level. As the NGFS previously stated, regulators and financial institutions can rely on non-financial data to tackle climate risks and a great deal of such data is already available. Much of it can be extracted from climate science and from the identification of activities that disproportionately contribute to climate change and/or are especially exposed to risks – notably fossil fuel development. Here again, these data can be used to implement a precautionary approach to climate risks by prioritizing climate mitigation and an orderly transition to limit the related risks.

In a word, without a precautionary approach to climate risks – and environmental risks more broadly – it will be impossible to truly account for them and manage them. For regulators worldwide, failing to consider the fact one company's impact on the climate and environment ultimately impacts its activity and value would be at odds with their financial prerogatives.

### **Specific comments on the questions from the consultation**

Q1.

Stronger focus should to be made on forward-looking data. Indeed, historical statistical data is not relevant to measure climate-related financial risks (see Bundesbank, *ECB and Federal Reserve Bank of Chicago, Summary of proceedings - Third Annual Joint Conference of the Deutsche Bundesbank, European Central Bank and Federal Reserve Bank of Chicago on CCP Risk Management*, 2021). Climate risks increase over time and have not been priced in in the past (see IPCC, “Chapter 15”, *AR6 Report*, 2022). In this context, knowing what are companies’ plans to address climate change is essential to

know what could be its exposure to these risks. Mandatory elements on standardized transition plans seems key to reach the FSB's goal.

Q3.

When looking at higher risk possibilities, the report should better emphasize the need to consider tail risk and compounding risks. It should also integrate the disruption dimension, which is due to non-linearity of climate-change.

Q4.

The report should be based on the principle of double materiality, which is key to understanding the systemic implications of climate-related risks and is already used in the EU (see Jean Boissinot and al, "Aligning financial and monetary policies with the concept of double materiality: rationales, proposals and challenges", *Inspire*, 2022). Without this principle, the FSB framework only aim at tackling a very limited and uncertain share of risks and totally ignore the contribution that the financial sector can make to the global transition.

Q5.

The impact of the financial system on climate change should be also considered, as financial institutions are "endogenous" actors, whose activities also have an impact on climate change and the pace of the transition.

Q6.

The report should highlight the limits of the current supervisory approaches, in particular limitations of stress tests and IAMs (see David Carlin and al, *Economic Impacts of Climate Change: Exploring short-term climate related shocks for financial actors with macroeconomic models*, 2022 / Nicola Ranger and al, *Assessing Financial Risks from Physical Climate Shocks: A Framework for Scenario Generation*, 2022 / Nicholas Stern and al, "The economics of immense risk, urgent action and radical change: towards new approaches to the economics of climate change", *NBER*, 2021). The referenced approach are still being developed and do not address the fact that we only have a few years to limit global warming – and therefore the related risks – to 1.5°C.

Q7 and Q8.

Considering the available evidence on the need to reduce fossil fuel consumption and production, there is a strong case for impactful prudential measures to recognise these risks such as capital requirements - Pillar 1 for microprudential risks and capital buffers for macroprudential risks (see Finance Watch, *A silver bullet against green swans*, 2021).

The IEA clearly stated that new fossil fuel projects are not compatible with its 1.5°C scenario and that they create a strong asset stranding risks (see IEA, *World Energy Outlook 2021*). All 1.5°C with "no/low overshoot" require a significant diminution of fossil fuel production by 2030 (see IEA, *World Energy Outlook 2021* / IPCC, *AR6 Report*, 2022 / *One Earth Climate Model*, 2022 / UN, *Production Gap Report 2021*).

Concretely, the need to stop fossil fuel development and to reduce production stems from the scientific fact that the current fossil fuel reserves already exploited are more than enough to drive global warming well-beyond 1.5°C (see IPCC, *AR6 Report*, 2022 / Kelly Trout and al, "Existing fossil fuel extraction would warm the world beyond 1.5 °C", *Environmental Research Letters*, 2022).

Additionally, it should be noted that fossil fuel infrastructures are also generally significantly exposed to physical risks from climate change (see IEA, *World Energy Outlook 2021*).

If setting up fossil fuel-targeted capital requirements could directly significantly contribute to climate risk management, it could also have an effect on climate change more broadly and therefore limit potential systemic risks.

Q9.

We would like to stress that the trade-off considerations included in the report are not justified. There should not be a trade-off between financial stability and other economic and financial considerations.