SESSION 4.
GREENING THE FINANCIAL SYSTEM: THE ROLE OF CENTRAL BANKS AND SUPERVISORS IN THE SUPPORT OF CLIMATE-FRIENDLY BUSINESSES UNDER FINANCIAL STABILITY

Knowledge sponsors: ADB and WB

Session 4 began with opening remarks by **Ms. Shannon Cowlin** | Country Director for Mongolia, ADB. She welcomed all participants to the conference and emphasized the growing importance of greening the financial system. She noted that the Asia-Pacific region, which is responsible for over half of global greenhouse gas emissions and is increasingly vulnerable to climate impacts, requires substantial investment in both mitigating and adapting the climate change. Ms. Cowlin also outlined ADB's efforts to build a financial ecosystem that supports low-carbon development and to scale up climate financing for developing member countries.

Keynote speech

The keynote speech was delivered by **Mr. Albert Park** | Chief economist at ADB, on the topic "Role of the central banks in greening the financial system". He discussed the importance of assessing climate risk for central banks and explored the role of central banks in promoting green finance.

Main points:

- Both the physical damage caused by climate change and the necessary transitions to Net Zero require significant adjustments in pricing and other economic activities. These changes will have a profound impact on economic outcomes. Hence, it is imperative for central banks, governments, and finance ministries to recognize and address the significance of these emerging risks to their economies and financial systems.
- By 2030, the losses associated with climate damage in a scenario of minimal action would be about 3.3% of GDP, escalating to 24% by the end of the century. These impacts are uneven across Asia, with Southeast Asia and India particularly hard-hit (ADB, 2023).
- Food prices are expected to rise by 10% by 2030, posing significant implications for food security and inflation, depending on how these price increases are transmitted.
- The ECB has introduced recommended practices for database analytics that central banks can implement. However, data challenges remain significant in many emerging market economies.
- The ISSB has approved its first set of standards for financial disclosure related to climate. If these standards are implemented consistently across regions, they will provide valuable data from entities that will be extremely beneficial for financial institutions and central banks, supporting a wide range of analyses.

- Climate financial risk mitigation should involve coordination with other government agencies on public investments in climate adaptation, insurance protection, and a national disaster prevention and response system.

Panel discussion

The panel discussion was moderated by **Ms. Elitza Mileva** | Lead Economist, Macroeconomics, Trade and Investment Global Practice in East Asia and Pacific Region, WB, joined by **Mr. Hamza Ali Malik** | Director of Macroeconomic Policy and Financing for Development Division, UNESCAP, **Ms. Sayuri Shirai** | Professor of Economics, Keio University, and **Mr. Albert Park** | keynote speaker.

Integrating sustainability considerations into central banks' operations and frameworks

- Central banks have essentially confronted with two challenges in addressing climate adaptation and mitigation considerations: one is safeguarding inflation and financial stability in the wake of complex climate change issues, the second is supporting climate action within the framework of green development policies.
- The government needs to implement a range of climate policies, including carbon pricing. It is very challenging for the central bank to move ahead of the government's actions in this area.
- Central banks can provide recommendations on effective policies for governments to address climate change. However, pushing central banks to use discretionary authority beyond their mandates could lead to deviations from good governance practices. In the long run, this approach may not yield prudent outcomes.
- Ensuring consistency between different ministries, especially the Ministry of Finance, and central bank policies is crucial. Government priorities must align with central bank' policies. If central banks are progressing in this area, they need the full support of the government.
- Once broad government policies are defined, central banks can support climate action using existing tools, without coming up with new frameworks:
  - First, monetary policy tools, which include financial market interventions such as collateral frameworks, direct and indirect monetary instruments like open market operations, refinance facilities, and non-standard instruments like quantitative easing (QE) and forward guidance. Second, prudential countercyclical measures to preserve financial stability, such as setting capital requirements based on climate risks. Third, other tools and instruments like screens and sustainable finance frameworks.

Challenges faced when starting the integration of sustainability considerations

- Understanding the challenges faced by central banks is crucial when incorporating sustainability into their operations and frameworks. While monetary policy aims to smooth our short-term business cycle fluctuations, it does not align with long-term structural green and transition policies. As a result, many central banks focus on forecasts related to financial stability. There is no disagreement on integrating climate factors into financial stability considerations.

- In emerging and developing economies, the accumulation of foreign reserves is a key consideration, and the main priorities are safety, liquidity and returns. But current green bond programs are not liquid and do not support green finance in these markets, so integrating climate factors into foreign reserve management presents a challenge.
- In advanced economies, central banks have accumulated bonds through quantitative easing (QE), with some incorporating green and climate factors into these assets. However, QE is not a permanent tool. As monetary policy normalizes, central banks may struggle to support green finance as effectively, revealing an inconsistency between monetary policy and structural green and transition policies.
- It is challenging for the central bank to introduce negative screening. This would require the central bank to engage in frequent allocation. If the central bank begins to enter this area, it becomes directly related to government policy. Hence, central banks must be particularly concerned and cautious about implementing negative screening[1].
- Measuring and evaluating climate-related risks is incredibly challenging due to the diverse physical conditions such as precipitation, droughts, floods, and extreme heat, all of which pose multifaceted economic challenges. Uncertainties regarding the timing, outcomes and pathways of climate change further complicate these efforts.

Promoting sustainability in the financial sector and key measures implemented

- Clearly distinguishing between transition and physical risks is crucial. Physical risks are location-based, which allows insurance companies to determine premiums accordingly. However, transition risks are more challenging to assess, especially without knowledge of GHG emissions. Therefore, promoting the disclosure of GHG emissions by companies, following Global Reporting Initiative (GRI) or ISSB-based standards, is essential.
- Central banks must collaborate with financial supervisory committees, responsible for listing companies and regulating the corporate sector's greenhouse gas (GHG) emissions. This metric is crucial. Once companies start disclosing their GHG emissions data, commercial banks can use this information to finance emission-reducing initiatives. This enables central banks to monitor how commercial banks are financing emissions, promoting a more integrated approach to tackling climate change.
- Coordination within the central bank is important, but equally important is coordination across all financial regulators. Taxonomy and disclosure require collective effort, thus consistent roundtables are crucial to ensure everyone is working toward the same goals.

[1] Negative screening is the process of finding companies that score poorly on environmental, social and governance (ESG) factors relative to their peers.

- In Hong Kong, monetary authority collaborates with government agencies to consolidate all climate-related data into a single repository, which makes easier to retrieve physical risk related data from one repository.
- To promote data disclosure for SMEs, Hong Kong monetary authority partners with the Climate Disclosure Protocol (CDP) to develop a set of simple questions tailored for each SME. Providing simple assistance to small banks and small enterprises is crucial.