Report on the GFSG – Private Sector Workshop "Modeling and Assessing Environmental Risks", Berne, Switzerland, May 11-12, 2016

To further the dialog between the G20 Green Finance Study Group (GFSG) and major global financial intermediaries and to advance the exchange of experiences within the private sector, the Swiss Federal Department of Finance hosted a workshop "Modeling and Assessing Environmental Risks" on May 11-12, 2016. The goals of the workshop, held under Chatham House rules, were …

- …. to take stock of existing financial industry practices in environmental risk modelling and risk assessment (institution level stress scenarios and stress testing) and to share experiences,
- …. to identify areas where there is common ground, where good industry practices may emerge and where obstacles to effective risk management may exist, and
- … to pinpoint priorities for further work on encouraging the mainstreaming of environmental risk management via better data, tools and methodologies.

The workshop made excellent progress and was particularly successful in fostering an open, engaged and constructive dialog among the different participants from major global banks, re-/insurers, institutional investors and asset managers, as well as from ministries of finance and central banks. There was a strong sense that this form of candid dialog launched by the workshop, built on practical experience and focused on knowledge sharing, should continue.

The workshop was structured around case studies from financial industry participants, whereby one session was devoted to banks, re-/insurances and institutional investors/asset managers each. This allowed distilling and discussing both sector-specific experiences as well as general and crosscutting challenges. The workshop concluded with a discussion on next steps. The methodologies and stock taking exercise in the University of Cambridge Institute for Sustainability Leadership (CISL) input paper to the GFSG on risk analysis provided important background, which received strong support from the participants.

The case studies and discussions clearly showed that major global financial intermediaries are engaged in technical environmental risk analysis and that many innovative practices are evolving. This is particularly true for the re-/insurance sector, where work on some core physical risks is advanced. In other sectors, and with regard to other sources of risks (i.e. transition risks), the work is still at an earlier stage in terms of data availability and quality, tools and methodologies as well as capacities devoted to environmental issues impacting the financial sector. The discussions confirmed that the development of environmental risk awareness is at an early stage among senior management, clients and politicians.

There was consensus among participants that a better general understanding of the financial implications of environmental risks is essential for better environmental risk mitigation, for a more effective internalization of external costs, and thus for mobilizing finance for green investment. There was agreement that longer investment horizons would help make environmental and climate risks more relevant, although the variety of business models in the different sectors will by nature be associated with differing investment horizons. While the desirability of more issuances of long-term assets was cited, especially on the part of the re-/insurance sector, the participants were also conscious that the readiness to take on corresponding risks would remain limited in the current low-interest environment and in light of high public debt levels.

Participants identified the following main common challenges:

1. *Adequate data or metrics are not readily available.* The desired move from a mainly qualitative to a more quantitative analysis requires access to better metrics. Several case studies demonstrated how data used by re-/insurers for their business models can be an important source of information for work in other sectors when assessing physical risk. There was a strong sense that better access to more granular data and data disclosures would be a key challenge to overcome, calling for better information and knowledge sharing.
2. *There is a lack of basic and commonly accepted methods or models.* Developing effective methodologies to support more forward-looking analysis of physical, transition and other balance sheet risks was identified as a key challenge. One case study showed how tracking carbon footprints had been helpful for taking stock of and identifying potential current risks, although footprints then turned out to be an insufficient tool for forward looking and dynamic risk analysis.
3. *Awareness of environmental risks has yet to take hold in the mainstream of the global financial sector.* Within many large institutions, but especially among smaller intermediaries, knowledge and awareness of the potential longer-term risks associated with climate and environmental change are still limited. Also, comprehensive methodologies to assess the different sources of risks (physical and transition) for a broad range of products have yet to be developed. Improving the dialog, knowledge and information sharing both within and among institutions across sectors as well as with and among politicians was identified as a key challenge. It was noted that there is a clear danger to a 'wait and see' approach, which may exist due to first mover disadvantage. Authorities can play an important role in facilitating progress. Addressing this mainstreaming challenge will require better metrics and methods for environmental risk assessments, as identified in 1. and 2. above.

In addition, there was recognition of the importance of better understanding the role that interlinkages between financial sectors play as a transmission mechanism for environmental risks.

There was therefore a call for action – on the part of both the private as well as the public sectors – to speed up the development of a common language through what one participant coined as an urgent need to improve shared "metrics, methods and models". Participants agreed that at this point in time, this could best be achieved by better knowledge sharing, including through intensive interactions as at the workshop. The participants supported the idea of establishing a common group to continue this dialog between the public and private, and within the private sector. Such an "Environmental and Financial Risk Group (EFRG)" could be established, jointly with the private sector, under the auspices of the G20, the FSB or another forum. The EFRG would be the leading platform for information and knowledge sharing. It would guide the development of shared metrics, methods and models with a view to spreading a more common language for environmental risk analyses in the global financial system. Participants agreed that such work would benefit from a coordinated and synergetic approach with the work of the FSB Task Force on Climate-related Finance Disclosure.

Among the GFSG members who attended the workshop, there was a strong sense that the workshop in Berne made more concrete the value of focusing on environmental sources of risk for finance ministries and central banks, drawing on the experience of the private sector.

<u>*Disclaimer:*</u>

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