Ref: Supervisory and Regulatory Approaches to Climate-Related Risks

Amsterdam, 30 June 2022

To whom it might concern.

This response from SOMO to the FSB consultation will focus on other issues that are missing in the data to be collected, integrated and used, with particular attention to the system-wide approach useful for macro-prudential policies and tools.

A. Regulatory reporting and collection of data

1. Regarding recommendation 1, there are some important climate-related data missing, in order for supervisors' and regulators' to identify exposures and understanding of the impacts of climate-related risks of financial institutions. Following the framework proposed in the FSB consultation on page 13-15, important qualitative data from banks, insurers, asset managers and alternative investment funds (hedge funds, private equity) that need to added are, regarding:

Governance:

- the remuneration of managers related to the achievement of climate related targets
- the influence of shareholders (via engagement, voting of resolutions at AGMs, informal channels, etc.) on governance on climate related risk appetite

Risk management:

- Risks in each category should be clearly divided into short term risks (within maximum 3 years), medium term risks (in 4 to 10 years) and long term (up to 2050) so as to avoid that current financing will result in medium to long term climate related financial risks
- Each of the risk categories should include social aspects that dynamically can reinforce climate related risks (see below)
- Whether due diligence has been applied when using ESG ratings and information from stakeholders has been consulted to verify the reliability of the unregulated ESG ratings

Strategy:

- What the strategy is for costs and spending in order to integrate climate related risks and impacts in the operations and investments, as compared to targets of profitability, and pay-outs for dividends and share buy-backs.
- What strategy is in place if lending or investing in climate friendly or sustainable activities, companies or projects will be less profitability than in climate changing and non-sustainable activities, companies and projects.
- Measures to reduce negative climate and sustainability impacts in order to reduce reputational risks
- Information from borrowers/counterparties/investees on decarbonisation plans and related social aspects (e.g. responsible disinvestment, costs of retraining employees, etc.)

System-wide and cross-border information:

- Feedback loops between the financial sector and the real economy should look into:
  - The level of debt of authorities, corporates and households to assess their capacity finance climate mitigation measures (respectively infrastructure, changing production or making heating climate friendly)
  - The levels of inequality, income and wages of the majority of the population, food prices and income of farmers, respect of human rights by companies and countries, trends in migration in sectors and regions where financial institute ions are operating, because these aspects affect the resilience of the economy and citizens to the impacts of climate change, and the actions by policy makers, which in turn will affect credit risk and market risk, and profitability of investees
- Interplay between (passive) investment fund managers holding shares of companies and financial institutions and reduced profitability of these companies and financial institutions when taking measures to mitigate climate related risks and impacts

2. Regarding **recommendation 2**, the reliability of data could be strengthened by ensuring that third-part verification firms are well regulated, at least to avoid conflicts of interest and promote transparency of methodologies and data used. Also, financial institutions should do due diligence by identifying potential reports and information from civil society and stakeholders affected by climate changing activities by borrowing and investee companies and projects.

3. Regarding **recommendation 3.** The high-level climate-related definition of transition risks should be somewhat more granular beyond 'behaviour' and 'social change' and include income insecurity, price changes and industry dislocations.

4. Regarding **regulatory reporting requirements**: There should be a much better recognition of the relationship between impacts and risks, between climate change, (non-financial and financial) corporate business models and society. Therefore regulatory reporting requirements should require reporting **on impacts** by lending or investing or other financial support to companies. This means that lenders and investors have to engage to get corporate data on borrowers' or investees their impact on climate change, the environment, social aspects (decent job (creation) and wages, respect for labour rights and human rights including impacts on communities in which they operate (e.g. land rights, housing rights), etc). Regulatory reporting requirements regarding governance should also include in what way aggressive tax planning is used and how much taxes are in this way avoided, and how supportive or not the financial institution and their borrowers or investees have been in their lobby position on regulatory or legislative proposals related to climate change and sustainable finance (e.g. a mandatory taxonomy, green/social/sustainable/harmful taxonomy).

B. Regarding the analytical tools for a system-wide perspective, and macro-prudential tools and policies for climate related risks, the following has to provide a more comprehensive assessment of climate related risks.

In order to better understand the spill overs, transmission channels, unexpected exposures and feedback loops, that will affect various risk categories, the following qualitative and quantitative information has to be integrated in scenario analysis and stress tests by supervisors and financial institutions, since they are currently riskily missing:

- The level of existing inequality, and especially the level of income, savings and indebtedness of the 50% or the majority of the population, in order to understand their resilience to necessary price increases e.g. for sustainably produced food, and costs to adapt their housing and means of transport, (re)training, and other expenditures for climate adaptation and mitigation.

- The level of respect of labour and human rights by corporations (e.g. based on human rights' policy reporting) and governments, that would provide a general basis for a just transition and promote support for measures preventing climate risks. In addition, information about what measures are in place by governments and corporations to protect the most vulnerable from being most affected by climate mitigating measures, in order to prevent social unrest, which would affect the economy and operations by companies and financial institutions.
- The potential for mass migration due to physical climate impacts in particular areas or due to total loss of livelihoods after dislocation of entire industries and services due to climate change policies.
- The level of reskilling and retraining needed to adapt to the transition and a carbon free economy.
- The level of wage increases needed to attract staff in carbon free economy and ensure basic services and activities are being performed in a just and sustainable way. This might impact the profitability of companies and investors after a long period in which shareholders have been pressing for low labour costs and have been divesting from companies whose labour costs were increasing.
- The percentage of (retail) investors willing to forego the highest profit in favour of positive contributions to effective climate mitigation throughout the value and supply chains
- The impact of fintech on awareness or not of the role of investments on climate change, e.g. due to the gamification of investing.

One of the potential macro-prudential tools would be to prevent dividend and share buy-back pay-outs by financial institutions that have not sufficiently integrated environmental short-to-long term risks case environmental risks.

The above comments and recommendation should provide more comprehensive information and tools for supervisory and regulatory interventions by authorities not only of the banking and the insurance sector, but especially in the sector of asset management as well as private equity and hedge funds.

For any questions you might have, please do not hesitate to contact me.

Yours sincerely,

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