

The Financial Climate Has Reached a Tipping Point

Having witnessed the turmoil of the Covid-19 crisis, markets are focusing on the risks posed by climate change. In fact, governments are now lagging behind in facilitating the financial industry's long-awaited shift toward more environmentally attuned standards and investment decisions, **writes Huw Van Steenis for Project Syndicate [here](#)**



Disruption is a powerful incentive to reallocate capital

The Covid-19 pandemic is sharpening financial markets' understanding of the need to address looming threats like climate change. This will likely be the year when investors and financiers decide to mainstream climate-transition analysis in their portfolios. Policymakers must recognize that markets are moving far faster than they are on this critical front.

This year, we have witnessed the biggest shock to the oil and gas market in 70 years. By the end of July, traditional oil and gas shares in the S&P 500 had fallen by 45%, Royal Dutch Shell had cut its dividend for the first time since World War II, and BP had written off \$17.5 billion from the value of its assets. At the same time, clean-energy stocks had risen by just over 20%, roughly the same as

the tech sector.

Disruption is a powerful incentive for investors and companies to reallocate capital. The sharp decline in energy prices has accelerated concerns about worthless “stranded assets” on companies’ books. A theoretical possibility has become a plausible scenario. Financiers are re-appraising their portfolios and weighing up the risks associated with a climate transition. So far, the key concern has been that green policies will work only if investors re-price the cost of capital for different firms.

If you can’t measure it, you can’t risk-manage it

There has also been significant progress on data and measurement, which is necessary for turning corporate climate talk into action and mobilizing capital at scale. Investors, lenders, and insurers have hitherto lacked a clear view of how companies will fare as the planet warms, regulations evolve, new technologies emerge, and consumer behavior shifts. Without this information, financial markets cannot price climate-related risks and opportunities effectively. Simply put, if you can’t measure it, you can’t risk-manage it.

The Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD), which was spearheaded in 2015 by Mark Carney, then the governor of the Bank of England (BoE), has been producing workable standards. Today, TCFD standards have been adopted voluntarily by more than 1,000 companies – including most global financial institutions – and thus are becoming the default norm.

In fact, we have probably reached the tipping point beyond which TCFD standards will win the day. Even though there has yet to be any regulatory push, a growing number of asset owners and their managers are pressing companies to report on these standards. The \$400 billion Canada Pension Plan Investment Board is merely the latest giant institution to tie its investments to both TCFD and Sustainability Accounting Standards Board standards. And the activist investor Chris Hohn has declared that his fund will press asset owners to fire fund managers who do not insist on climate transparency.

But data alone is no panacea

Another encouraging development is that competing standard-setting bodies, anxious that they will miss out on becoming the source of industry benchmarks, are starting to collaborate. As more jurisdictions move to codify new standards, those that do not risk becoming irrelevant. Similarly, the top data-analytics firms and index providers are buying or building capabilities to help investors fashion more climate-aware portfolios along the same general standards. As the cacophony of competing standards subsides, more financial-market participants will follow.

But data alone is no panacea. Measuring and assessing long-term trends and the interactions between climate science, public policy, economics, and financial markets is a complex undertaking. In a world of interconnected global supply chains and intersecting legal, regulatory, and operating environments, it is not easy for market participants to make sense of the potential impact of climate change and the strategic responses to it.

That is why central banks are introducing stress tests, a crucial tool for ensuring proper risk management, resilience, and transparency in the financial system. Already, 15 central banks have rolled out climate stress tests not just for banks, but also for insurers and, in some

jurisdictions, pension funds.

To create a solid foundation for this process, the Central Banks and Supervisors Network for Greening the Financial System has worked with climate scientists and investors to devise three probable climate-policy scenarios. The idea is to determine whether firms are “transition ready” for a lower-carbon economy. Such tests should help to bring climate risks closer to the center of financial decision-making. But it is important to remember that central banks’ remit is limited to economic and financial resilience. They will only ever be able to offer a partial response to the broader climate challenge.

The European Green Deal is a great opportunity

Policymakers and regulators must catch up to where markets are heading by supporting the effort to develop common “decision useful” standards. As I argued last year in the BoE’s Future of Finance report, the best solution would be to apply the TCFD framework across all financial accounts. That said, policymakers must maintain flexibility and humility to avoid hard-coding obsolete standards or creating a mountain of red tape.

Equally important will be public policies that drive a smooth climate transition, such as those proposed in the European Green Deal. So far, few governments have been willing to stick their necks out by implementing a carbon tax. Yet behind the scenes, most investors and financiers already acknowledge that such a tax would accelerate the shift to a low-carbon economy. According to Refinitiv, a carbon price of \$75 per ton would cost global business around \$4 trillion. As my colleague, UBS chair Axel Weber, points out, that would profoundly change incentives, possibly giving rise to a large tradable-emissions market.

Finally, to move not billions but trillions of dollars in the right direction, we need what Carney has called “50 shades of green.” No single financing model or investment position will suffice. Portfolio exclusion, engagement, and impact investing all have their uses as well as their own challenges. The most important objective is to mobilize capital, which means avoiding a set of purist rules that would overly limit the possibilities for proper portfolio diversification.

Warren Buffett’s hypothetical advice to an investor seeking to profit from the nascent car industry in 1900 – “short the horse” – is worth considering today, argues investor Ewen Cameron Watt. Successful investment is often as much about avoiding losers as picking winners. Markets are pivoting, and policymakers should take note.

The full and original article first appeared on Project Syndicate [here](#) on 23 September 2020.

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist
+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Robert Carnell

Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com

Karol Pogorzelski

Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com