Financial regulators hold the key to climate change

Central banks and regulators should be on the frontline of fighting the carbon emissions driving climate change, and a more proactive approach can address the visible side effects in Asia, such as the annual choking smoke haze that envelops parts of the region.

Authorities should take account of climate risks as part of their duties of oversight, and "green finance" should play a major role in ensuring the investments needed to promote development are conducted in a sustainable fashion, says Ulrich Volz of the SOAS University of London.

Green finance is defined as all forms of investment or lending that consider environmental factors.

This is particularly important in Asian economies, including the Peoples' Republic of China, where pollution and carbon emissions have been a significant brake on growth due to issues ranging from water and air pollution to higher healthcare costs.

> First of all, there are physical risks—we know from a lot of scientific analysis that climate change is increasing the frequency and intensity of natural disasters, and there are plenty of examples also in the Asian region where countries have been hit by such natural disasters and the costs are quite substantial. If parts of the economy are hit, this may also have an impact on the financial system. Beyond these, natural disasters and longer-term climate change can have impact on different sectors of the economy, so for example, the agricultural sector, which is a very important sector for very many regions in this section, will very directly feel climate change.

Volz says this may have powerful implications through higher food prices due to ruined crops, with related implications for the financial sector and the economy through slower growth and inflation.

> There are other forms of risk as well, and the second form of risk are transition risks. If countries are serious about the Paris agenda, and kind of reducing carbon emissions, this will have to lead to quite dramatic changes in economic policies.

Volz cited the use of carbon taxes, which can have a broad-ranging effect on large employing sectors of the economy such as oil and gas.

One of the key problems for countries, even those with good environmental laws, is enforcement, he says.

> Environmental regulation, to a certain degree, is not binding, especially for the big polluters, and we see that every year with all these peak fires and all of the haze across Southeast Asia.

He was referring to burning off bush land and forests to plant palm oil in Indonesia and Malaysia.

The solution, Volz suggests, is financial regulation that is binding.

> So, if the central bank or financial regulator kind of makes sure or demands from financial institutions that they take into account environmental risk. That is quite a powerful way of kind of addressing inappropriate behavior in the corporate world. I think especially in developing countries where institutional frameworks and environmental industry are not well-working, central banks and regulators can have a really powerful impact and really make a difference.

The Peoples' Bank of China has been active since the 1990s in addressing environmental damage, working with some of its global counterparts on sustainable finance. China since 2007 started to include environmental risk in analysis, and has developed green credit guidelines, which have been developed since 2012. Voluntary guidelines are now mandatory and China has become "super active" in green finance, says Volz.

> China likes to portray itself as a leader in global climate change, but I think to be fair, the more immediate need is local pollution, but the good thing is that pollution from coal-fired power plants, if you address that, you also address the problem of climate change.

Bank Bangladesh has since the late 2000s requested banks to include different environmental risk analyses, and it requires commercial banks to allocate a certain percentage of lending to green lending.

Other countries, including Indonesia, Mongolia, and India, have developed more comprehensive guidelines for financial institutions. These are not binding guidelines, but they will likely lead to financial regulation, and there are stock exchanges or security regulations that have been implementing different guidelines or listing requirements, so a lot is happening in this area.

Green, sustainable investment is really a tiny portion of total investment, so it is a record-growing niche market.

> Basically, the main points are to successfully have the green transformation to a low-carbon economy, we need to involve the financial sector. Financial governance has an important role to play, lining the financial system with sustainability, and we actually do have quite a lot of positive examples form the last couple of years worldwide, but also in Asia. A lot of interesting stuff is happening…unfortunately things are not happening as rapidly as we need them to happen, so there is still a lot to do.

That was Ulrich Volz, head of the Department of Economics, SOAS University of London, speaking at an Asian Development Bank Institute series, "Green Finance Challenge," in Tokyo in April 2018.

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