Climate Action Simulation: Banking and Finance

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To: **Chief Negotiators for Banking and Finance Sector**
Subject: **Preparation for the Climate Action Summit**

Welcome to the Climate Action Summit. You and leaders from all relevant stakeholders have been invited by the UN Secretary General to work together to successfully address climate change. In the invitation, the Secretary General noted that: "The sound you hear is the ticking clock. We are in the final countdown to limit global temperature rise to 1.5 degrees Celsius. And time is not on our side….But there is every reason to hope…. We need a new finance goal that meets the moment. Five elements are critical to success. First, a significant increase in concessional public finance. Second, a clear indication of how these public funds will mobilise the trillions of dollars developing countries need. Third, tapping innovative sources, particularly levies on shipping, aviation, and fossil fuel extraction based on the principle that polluters must pay. Fourth, a framework for greater accessibility, transparency, and accountability…, Fifth, boosting lending capacity for bigger and bolder Multilateral Development Banks…. The resources available may seem insufficient. But they can be multiplied with a meaningful change in how the multilateral system works. Big sums require big change….There is no time to lose…the world must pay up, or humanity will pay the price."

The goal of the summit is to agree on a plan to limit global warming to less than 2°C [3.6°F] above pre-industrial levels and to strive for 1.5°C [2.7°F], the international targets formally recognized in the Paris Climate Agreement and reaffirmed at every summit since. The scientific evidence is clear: warming above this limit will yield catastrophic and irreversible impacts threatening the health, prosperity, and lives of people in all nations, and of course, the profits and even survival of your institutions.

Your group includes chief executives of the major public and private financial institutions of the world, including the World Bank, International Monetary Fund, Asia Development Bank and its counterparts in other regions, insurance and reinsurance firms, commercial banks, investment banks, asset managers such as BlackRock, and asset owners including endowments, pension funds, and the sovereign wealth funds of Norway, Saudi Arabia, and other nations. Public entities in your delegation such as the World Bank have an explicit mission to promote economic development, equity, and sustainability. Private entities seek to maximize the return on their investments and have fiduciary responsibilities to their shareholders and clients.

You all recognize the severe harm to the world and to your portfolios if climate change is not limited to the Paris targets. Climate change creates *physical risks* to the assets you have invested in and insured: drought, flood, sea level rise, wildfire, migration, civil unrest, conflict and other harms from climate change threaten your investments and trigger insurance claims. But you also face *transition risks*: Your portfolios are diversified but include substantial loans and equity positions in the energy sector, including fossil energy and industries reliant today on fossil energy (transportation, cement, steel, petrochemicals, and other heavy industry, etc.). Dramatic changes in energy policies might threaten the return on these investments by, for example, leading to stranded assets.

In the negotiation you have an interest in preventing the adoption of policies and regulations that unfairly burden your portfolios and the people and investments you fund. Nevertheless, many of you have publicly committed to reducing the carbon footprint of your operations and portfolios. While seeking to protect your portfolios from severe transition risks, you must also seek to reduce greenhouse gas emissions and slow climate change so you can remain profitable, and survive, in a warming world. As Paul Polman, former CEO of Unilever, is reported to have said, "There is no profit on a dead planet."

The transition to a net zero emissions energy system and economy will require significant capital—trillions of dollars through 2050 and beyond. Governments can help but the policies you adopt and the capital allocation decisions you make are essential if the plans and pledges of governments around the world are to be realized. In particular, the developing nations do not have the resources to create the infrastructure for a zero-carbon economy and will not commit to reducing their emissions without significant funding, public and/or private, to do so. You are in a unique position to shape the funding required for all nations to cut their emissions in time, but you must also ensure you do not violate your fiduciary responsibilities.

Your policy priorities are listed below. You can, however, propose, or block, any available policy.

1. **Negotiate agreements that provide funding, technology, technical assistance, and other resources to the developing world so they can undertake the investments needed to build a green economy**. Your financial backing can help bridge the gap between the positions of the different national groups in the negotiation. Loan guarantees for sustainable projects, green bond programs backed by governments, and other policies can reduce the risks to private investments in emissions reductions and green energy at low cost to governments, and can significantly increase the flow of private capital into the emerging low- and zero-emissions technologies and sectors, and especially into the developing nations. Point out to the developed nations that these actions and direct investments are not "aid" or charity but investments in their own future security—without deep emissions cuts by all nations, all will suffer, including developing, rapidly emerging, and developed nations.
2. **Avoid funding projects that are at high risk of becoming stranded assets.** You should avoid funding new projects in fossil energy production, especially in coal, but including oil and possibly fossil (so-called "natural") gas. For example, you could support (and even enact) a policy ending all new coal infrastructure investments. Just note that some in your coalition will be left holding stranded assets in that scenario, particularly those with balance sheets containing reserves of fossil fuels.
3. **Support and fund projects that increase energy efficiency.** Energy efficiency means using less energy to provide the same goods and services. Raising energy efficiency sometimes increases up-front costs but reduces operating costs, generating savings over the long term, and is therefore ripe for financing mechanisms. Efficiency improvements can be an attractive option to reduce greenhouse gas (GHG) emissions. For example, research shows that green, efficient commercial buildings command higher rents and selling prices compared to typical buildings. Real estate is of course a large component in many of your portfolios. Unlike many of the investments in your portfolios, the technology to boost efficiency in buildings and industry is largely available now, so efficiency upgrades pose little risk. For example, a deep energy retrofit of an existing building or industrial facility faces little to no market, counterparty, systemic, or technical risk.
4. **Support and fund projects promoting green, zero-emissions energy.** Renewable energy sources including wind and solar, with storage, are now cheaper than all fossil energy sources in most parts of the world. But fossil projects are still subsidized by governments in many nations. Policies that incentivize these technologies will speed cost reductions through scale and learning effects, reduce risk, and increase the business case for funding these energy sources.
5. **Support market-based policies instead of a patchwork of regulations.** Gradual phase-in of a significant price on carbon emissions would create strong market signals promoting efficiency, clean energy, and innovation in industrial processes and transportation that will reduce the risk of investments you make in these sectors while cutting greenhouse gas emissions. A significant price on carbon pollution would therefore reduce physical climate risks to your portfolios in every region of the world and every sector of the economy. Carbon prices are more efficient than a patchwork of regulations and simpler to implement, administer, and monitor for compliance. To ensure equity and avoid political conflict or even civil unrest, consider rebating the revenues from any carbon price back to the people of each country, for example on an equal per capita basis. These "carbon dividends" will prevent the carbon price from being a regressive tax that harms the developing nations and the poor in every nation, increasing the chances of implementation and enhancing the global stability that is essential for risk reduction in your existing portfolios and potential new investments. That said, a significant carbon price would increase operating costs for energy-intensive assets in your portfolios, and will cause fossil reserves to become stranded. Therefore, you see a gradual phase-in as essential, avoiding the disruption and volatility of an abrupt transition.

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