

## **Consultation on the renewed sustainable finance strategy**

Climate change is one of the major challenges of our time, and it requires a global transition to a low-carbon economy. The transition will require structural changes both in the real economy and in the financial system. To manage this transition, political decisions will be required. As a central bank, the Riksbank needs to respond to climate change. One reason for this is that climate change affects the Swedish and the global economy and in turn may also threaten both price stability and financial stability.

Both the effect of global warming (physical risks) and the transition itself (transition risks) give rise to financial risk – credit risk, liquidity risk, market risk – as well as operational risk. The magnitude of those risks and their distribution over time depend on the level and timing of mitigation measures. If they are not managed, they can entail risks for the financial system, which can in turn have financial stability implications. Therefore, it is important that financial and non-financial corporations seek to identify, assess and manage their exposure to these risks. The work of central banks and regulators is amongst all to ensure that international financial market regulation mitigates the risks of climate-related financial instability, in the same way as central banks and regulators have worked to combat other systemically important risks in the financial system.

Better access to information is a pre-condition for banks, insurance companies and other participants in the financial sector to be able to effectively measure, price and manage their exposures to climate-related risks. The Riksbank considers that improved and uniform disclosure of climate-related risks and opportunities by both financial and non-financial corporations is one of the main actions required (in line with the TCFD recommendations).

Climate change is a risk we see looking forwards not backwards. Important tools for the assessment and management of climate-related risks are climate scenario analysis and stress testing. In June 2020, the Network on Greening the Financial System (NGFS) published a harmonized set of high-level climate scenarios. The Riksbank considers these to be useful not only to central banks and supervisors, but also to financial firms and corporates as they seek to manage their exposures to these risks.

At international level, it has been discussed whether banks' capital requirements could be eased in order to create an incentive for more sustainable investments (so-called Green Supporting Factor). Even though the intention is good, the Riksbank considers this to be inappropriate. Capital requirements exist for a reason – to build resilience in the financial system. Eroding these requirements risks undermining financial stability. The Riksbank's view is that capital requirements should be set based on financial risks and not used as an instrument to distribute capital. The discussion on banks' capital requirements should therefore take its starting-point in risk. Watered-down banking capital requirements is not the right way to promote sustainable investments.