A Balanced Approach to Green Finance

(Keynote speech by Mr. LEE Joonsoo, Deputy Governor of Korea Financial Supervisory Service, at the webinar titled "Green Finance Development in Japan and Korea", co-organized by Green Finance Network Japan and Green Finance Forum Korea, on June 2, 2022)

Good afternoon, everyone. Konnichiwa. Annyeonghaseyo.

Many thanks to the organizers for inviting me to speak on green finance at this webinar.

Today, I'd like to stress the need for a balanced approach to green finance. Although the points I want to make might be taken for granted by many of us, I think they are the key success factors in our journey to net-zero economies.

Recent developments in sustainable finance markets

Let me start with a brief overview of the recent developments in the sustainable finance markets.

Global financial markets have seen a sharp increase in sustainability-related products such as green bond, social bond, sustainability bond, sustainability-linked and transition bond. According to a recent report by Climate Bonds Initiative, sustainable debt issuance surpassed 1 trillion USD in 2021 for the first time, with a cumulative volume of 2.8 trillion USD as of the end of 2021. However, we still have a long way to go. The Intergovernmental Panel on Climate Change (IPCC) claims that financial flows for climate mitigation will need to increase by three to six times this decade if global warming is to be limited to 1.5°C. Also, a recent analysis by the Institute of International Finance and Pictet Asset Management says that achieving net zero targets by 2050 may require the climate bond universe to reach $36 trillion by 2025 and over $60 trillion by 2030.

The market architecture for sustainable finance — including disclosures, taxonomies, climate data and ESG ratings, supervision of climate risk — has also been evolving rapidly as both the public and the private sector strive to align the financial system with net-zero targets and mobilize capital for the transition. In recent years, the scope and volume of policy and regulatory instruments on green finance have expanded exponentially, with the UN Green Finance Platform identifying more than 680 unique policy measures in place around the world. This year, sustainability reporting and disclosure has taken a big step forward as the International Sustainability Standards Board (ISSB) released the climate disclosure exposure draft as a global baseline standard, with the U.S. Securities

and Exchange Commission (SEC) and the European Financial Reporting Advisory Group (EFRAG) launching a public consultation on the draft climate disclosure rules and sustainability reporting standards respectively. We have also seen a rising number of market-led Net Zero campaign activities. More than 25 different Net Zero coalition have been launched, covering the energy, agriculture, industry, transport, and buildings sectors, with the Glasgow Financial Alliance for Net Zero (GFANZ) alone gathering 450 firms from 45 countries.

However, the recent geopolitical events in Ukraine and Russia amid the global pandemic and US Fed rate hikes are likely to make our journey to net-zero much bumpier. Soaring prices of key commodities such as oil, natural gas and wheat are causing economic and financial disruptions around the world, potentially affecting our path to net-zero. For example, the EU is reconsidering timelines for reducing fossil fuels to make up for the shortfall caused by supply shocks, and recalibrating its energy policies to build greater security. To put it another way, we are facing the trade-offs between speeding up our efforts to achieve net-zero targets and tackling other economic, political, and social issues.

A need for a balanced approach to green finance

Against this backdrop, I argue for a balanced approach to green finance. What I mean by a balanced approach is, broadly speaking, to manage effectively the potential trade-offs between the intended and unintended consequences in implementing green finance strategy. Recently, Ms. Sarah Breeden, a member of the U.K. Financial Policy Committee[1], spoke about the unintended consequences of the net-zero policy. For example, certain policy choices might deprive emission-intensive firms of access to finance that is needed urgently for transition. Limiting finance to high-carbon firms too strictly before sustainable replacements are widely available could cause unwarranted economic, social and distributional consequences. Moreover, the extremely rapid changes in the prices of green assets and emission-intensive assets could lead to market instability.

Then, what should we do in practice to implement a balanced green finance strategy? I'd like to highlight the need for three balancing measures: 1) facilitating "transition finance" along with "green finance" 2) promoting "green finance for small and medium sized firms" along with "green finance for large firms", 3) seeking "regulatory intervention for market integrity" without doing any significant harm to "market efficiency and innovation".

[1] Balancing on the net-zero tightrope – speech given at TheCityUK International Conference by Sarah Breeden

First, there is a need for facilitating "transition finance" along with "green finance".

We have to ensure that capital is provided to not only the existing green activities but also those that need greening and responsible retiring, especially in the hard-to-abate sectors. To achieve the Paris Agreement's goal by the end of the century, it is essential to finance the efforts for shifting the emission-intensive industries to decarbonization. It would be a folly for green finance policy to focus exclusively on zero or near-zero-emitting activities and exclude many other intermediate activities. Of course, transition finance should only be provided when no net-zero or near-zero alternatives are available, and technology lock-in and emission can be avoided. Moreover, in order to mitigate against greenwashing in transition finance, we need to make sure that transition taxonomies are science-based and firms' transition plans are transparent and accountable based on high-quality climate disclosures.

In this context, an increasing number of jurisdictions are exploring transition taxonomies and classification instruments to develop transition finance markets. Some countries are developing new frameworks for transition finance, while others consider expanding green taxonomies to include transitional activities. Countries have also been increasingly focusing on how to facilitate interoperability and comparability of jurisdictional taxonomies, frameworks and principles.

Second, there is also a need for promoting "green finance for SMEs" along with "green finance for larger firms".

Given SMEs' significant aggregate environmental footprint, countries have implemented an increasing number of SMEs-oriented policies to reach climate objectives, mainly covering the provision of information and advice, regulation, as well as economic and financial incentives. However, most SMEs are still at the early stage of their net-zero transition. While their awareness is improving, SMEs have relatively limited access to resources such as skills, finance and technology than larger firms have for greening. In particular, access to finance is still considered one of the main challenges that SMEs face in the transition. A recent survey by UN-backed SME Climate Hub shows that approximately 70% of SMEs need access to external funds to reduce their emissions, with only 8% of SMEs owners having received support from banks.

Therefore, there is a need for greater policy efforts to facilitate access to climate finance by SMEs, given the current green finance markets are more suited to supporting large firms. To this end, the public sector, such as public authorities, policy institutions and multi-lateral development banks, needs to play an active role in helping SMEs attract more private sector financing for their sustainable activities, specifically by providing de-risking mechanisms as well as advisory service.

For example, public agencies can help de-risking SMEs' sustainability projects by providing guarantees or subsidies, thereby allowing more commercial financing available to SMEs. Moreover, climate and environment related regulations, such as reporting and disclosure requirements, should be applied to SMEs based on the principle of proportionality without imposing too much regulatory burden. It is also important that governments make efforts to provide capacity building and technical advice to SMEs with regard to regulations.

Third, "regulatory interventions for market integrity" should be sought without doing any significant harm to "market efficiency and innovation".

The rapid evolution of the green finance markets has led to potential risks of fragmentation, lack of transparency, and misconducts such as greenwashing, which could constrain the growth potential of the green finance markets. Thus, national or regional regulators and international standard-setters are stepping up their efforts to formulate regulatory standards or principles so as to strengthen market integrity and transparency. The key areas that regulators and standard-setters are focusing on include disclosure, taxonomies, climate risk supervision, climate data and ESG ratings.

Although efforts by the regulators are urgently needed, regulators need to be cautious of any unintended consequences along the way. For example, overly strict or simplified rules might fail to consider the variety of market practices, hindering efficiency and innovation in the markets. Therefore, policies and regulations in green finance had better be designed and implemented in close consultation or collaboration with various market participants. In the end, we may need both regulatory approach and market-based approach to ensure integrity in the green finance markets.

Conclusion

Now, let me conclude my speech with a phrase we commonly hear: The transition to net zero is not a destination but a journey. Indeed, what really matters is the path we take. And it is true that the path seems rockier than expected, given recent events.

Although we need to act quickly and boldly to tackle the climate crisis, we cannot ignore the financial, economic, and social consequences caused by our climate actions.

This is the very reason why we need to pursue a just and inclusive net-transition.

A balanced approach to green finance will support it.

Thank you very much for your attention.

※ The views expressed here are not necessarily those of the Korea Financial Supervisory Service.