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Open Letter to G7 and G20 Finance Ministers and Central Bank Governors:

Plans for re-shaping of the international financial system took center stage at the World Bank/International Monetary Fund (IMF) meetings in Washington, DC this week. In these concluding days, we urge authorities to prioritize financial system reforms that promote financial stability, as well as transitioned-aligned allocation and treatment of financial stock. These are prerequisites to an orderly and just transition to a net zero economy, and use of ex-ante, or precautionary, policy tools can be catalytic.

A new event this spring jointly hosted by the IMF and the International Organization of Securities Commissions (IOSCO) was a welcome development. Banking and securities markets regulators joined with senior economists from the U.S. Treasury Department and the IMF to share insights and best practices on risk management of the nexus between banking and capital markets. They described policy tools used in the pandemic to address the March 2020 'dash for cash,' such as how central bank balance sheets were stretched to take on corporate and municipal securities. Current approaches for oversight of money market funds and other non bank financial institutions were shared, as well as current concerns about risks posed by private equity. India, Japan, and the U.S. shared country level experiences, and there was unanimous agreement that ex ante -- before the event, precautionary approaches -- were critical, preferred, and cost effective.

Ex-ante, precautionary approaches are especially warranted for addressing climate-related financial risk – including physical risks, transition risks, and the interactions between the two. This is because of climate change's significance, as well as its uncertainty and irreversibility. The financial system is overly reliant on backward-looking data and approaches that cannot capture climate-related risks; use of such data and reliance on external corporate ratings contributes to the underpricing of risk.

Financial market resiliency will be essential to mitigating risks, enabling a just transition and supporting. economies that will be undergoing large structural changes. Those who delay using or weaken ex-ante approaches could not only imperil financial institutions and financial system stability, but also miss critical development opportunities being created as capital reallocation toward renewables accelerates.

The effectiveness and reasonableness of ex-ante regulatory approaches make it difficult to accept what has recently been reported about the status of ongoing international work on climate related financial risks, and how to manage them. Frictions between U.S. and European members of the Basel Committee on Banking Supervision (BCBS) on these issues recently spilled over into public view. U.S. banking regulators apparently weakened the robustness of a key ex-ante tool, transition plans, by making the guidelines 'optional'. While it is admittedly early days for transition plans, real economy actors' transition plans can help financial markets and policy makers more efficiently see and price climate related risks, taking some of the 'guess work' out and improving the design and impact of ex-ante financial stability tools, especially as they are refreshed over time.

U.S. authorities also apparently declined to contribute to a climate/credit risk analysis exercise, although they have taken the position that climate risk can take the form of credit risk. The U.S. was cited in efforts to have the BCBS to reverse course on a long range climate-related work plan and apparently cancel a planned re-assessment of climate change's implications for capital standards, and weakened disclosures of climate-related financial risks.

It's easy to attribute U.S. banking regulators' disappointing lack of support for the BCBS initiatives to the toxicity of the current U.S. political environment. The U.S. Securities and Exchange Commission's pared back climate disclosure rule is another manifestation of this. And some U.S. legislators are opposed to adopting any policies that were developed as part of international coordination efforts. Still, the U.S. context cannot serve as the limiting frame for worldwide progress.

As authorities close out the Spring 2024 meetings, we urge them to make plans now for prioritizing the use and implementation of ex-ante policy approaches. Using ex-ante measures creates more time and space to better adjust macroprudential and other tools to address climate change. This approach would empower policymakers to help the real economy absorb climate-related shocks, and limit the potential for financial sector contagion, or for negative financial sector feedback loops to spill over into the real economy. The IMF noted in 2023 that an orderly transition to net zero by 2050 could result in global gross domestic product being 7 percent higher than under current policies. We can ill afford to leave that on the table.

Signed by:
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