Finance Water Action Pathway – Introduction and First Draft

February 2023

Background

In December 2022 CDP, The Organisation for Economic Cooperation and Development (OECD) and the Water Footprint Network (WFN), funded by the Dutch Government, kicked-off a project dedicated to Catalysing the Water Action Agenda for Finance.

One of the main outputs of the project is to put together a first-of-its-kind **Finance Water Action Pathway**. The partners will leverage their expertise in e.g., the field of financial services sustainability disclosure, capital markets, water foot printing and water security. We will also use our existing, extensive networks to engage and consult with various financial actors and selected experts to help us along the process of building a first draft Pathway. The Pathway concept will be endorsed in New York in March 2023 at the Water UN Conference.

Given the many sustainability challenges the finance sector is facing, we strive to align our Finance Water Action Pathway with ongoing/existing initiative. Specifically, we based our draft pathway structure on the UN's Climate Action Pathway for Finance, and it will consist of sections presenting the vision by 2030, a system transformation summary, the key levers of change and the specific actions to be taken within each area and the existing progress made on the issue. Last but not least, the Pathway will set high level vetted, ambitious, specific, measurable, actionable and timebound milestones for the financial sector.

Purpose and Ambition of the Pathway

Water, as an inseparable part of nature and economic stability, is an essential resource that needs to be considered by financial institutions when making decisions about their portfolio activities. Financial institutions (FIs) have the power to influence or incentivize the transformation of whole sectors in ways that single governments cannot. Through their lending, investment, insurance and underwriting practices, FIs can drive the various water users to use water wisely, to not pollute it, and to promote its reuse. Financial institutions can spur the development, upscaling and uptake of critical technologies, policies and practices through the adoption of bold commitments to water security and through their cascading influence on the entire economy via portfolio holdings, loan books and other assets. Each sends a strong signal from the private sector to government in support of ambitious climate and water policy, serving to close the ambition loop (Water-Climate Action Pathways).

Water security is important because of its double materiality. It is material to the financial sector, as seen in CDP's report 'High and Dry: How Water Issues are Stranding Assets' published in May 2022, showing that US$ 13.5 billion has already been stranded as a result of water risks, and a further USS$2 billion is at risk on four major infrastructure projects in the gas, coal, mining and power generation sectors. Risks like these are abundant: 69% of listed equities disclosing via CDP report exposure to physical or transition water risks that could generate a substantive business impact in the next 3 years. Despite the evidence that water is material to the financial sector, CDP research has shown that one-third of listed financial institutions are not assessing the exposure of their activities to water issues. Our analysis indicates that substantive corporate value may be at risk due to worsening water insecurity with the value at risk topping out at 225 billion dollars. Production could slow or halt. Disputes over water could lead to reputational damage. Assets in water-stressed regions could become stranded temporarily, or permanently, if assumptions made about water availability and access prove inaccurate, regulatory responses are unanticipated, or if risk mitigation and stewardship

plans are not put in place. All financial actors are vulnerable to nature-related financial risks, and the financial materiality of nature loss evidence constitutes an urgent call to action.

At the same time, the financial sector emerges as a sector with critical impact on the world's rivers, lakes aquifers and streams. Financial institutions are polluting and deteriorating water systems through the business activities that it finances and enables (CDP, 2021). Water Watch, CDP's Water Impact Index, points out the negative impact the sector has through the flow of money provided to companies, enabling agribusinesses to pump ever increasing amounts of non-renewable groundwater, it is enabling tailings dams to be constructed at the heads of free-flowing rivers and it is enabling chemical, apparel and pharmaceutical companies to release toxic pollution, much of which is carcinogenic, posing a real and present danger to human health. These impacts are multiple, not just environmental, but also social and economic in nature. The impact that financial institutions have on water has an economic cost for society at large, which leads to social inequality and a financial burden for taxpayers. Therefore, financial institutions have a shared responsibility in avoiding and/or mitigating adverse impacts.

This pathway will include both materiality lenses and a broad view on water-related impacts. The Finance Water Action Pathway aims to present:

- A clear **vision** of how the sector should look like in 2030.
- Critical **steps** that need to be taken to successfully transform the financial system.
- Key areas through which financial actors can have a positive impact on water security (**levers** of change).
- Measurable and timebound **milestones** for each lever of change.
- Specific, practical and science-informed **actions** to achieving the ambitious goals.

Finance Water Action Pathway – First Draft

Vision

Its 2030, business, trade and financial decisions from the public and private sectors prioritize and align with the protection, sustainable use and reuse of freshwater resources and ecosystems, providing direct finance, green jobs, market signals and incentives that continue to drive the innovation required for further water transformation.

Water infrastructure and services – both man-made and natural – have been planned, adequately financed, and built to be robust and flexible across a range of possible climate futures. Financing is only provided to farms that use regenerative agricultural practices that achieve sustainable water footprints and has turned it into the norm all over the world, safeguarding farmers and their livelihood.

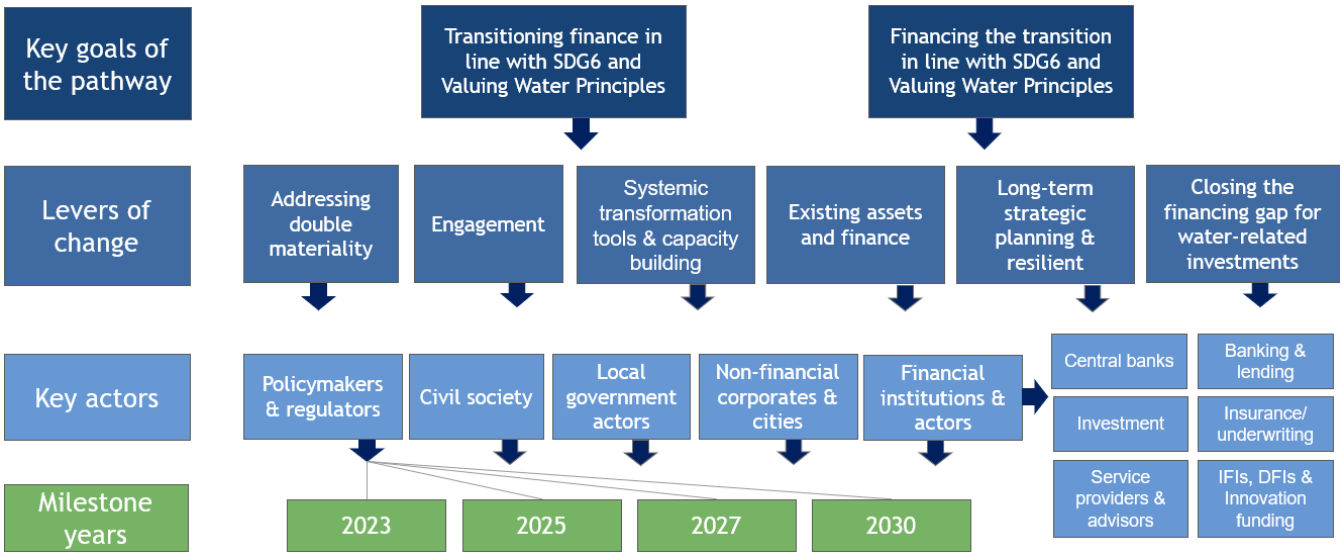
The financial sector, through the activities and businesses it's funding and enabling, makes sure that people living in water-stressed regions are thriving, and have universally accessible, safe and adequate water supplies and sanitation services, effectively preventing and containing pandemics such as COVID-19 while raising all people out of poverty and ensuring the human right to water and sanitation is fully realized.

Thanks to the strong signals that the financial sector has sent to the government through adoption of bold commitments to water security and strong influence on the entire economy, governments have prioritized water governance at the highest levels. Adequate and effective cross sectoral institutional, legal, and regulatory frameworks are now in place. They have provided resources for implementing and promoting sustainable and resilient water management, sustainable water provision and allocation, and protection of people and places while also providing appropriate government incentives that ensure water is directed to societies' most essential needs, especially those of the most vulnerable.

System transformation summary

To deliver our 2030 vison, it is essential that finance and the power of markets are harnessed in the service of delivering a just and smooth transition to a water secure global economy that accounts for the water impacts of its activities. If we transform finance to consider water security in every business decision, then the result will be that the financial system enables the transition to a water secure future.

System Transformation Overview



To achieve this, every actor of the financial system (see graph above) will have a role to play. We aim to outline the specific elements and actions expected from each of the suggested actor groups that participate in the system transformation on the way to achieving the vision:

Policymakers and regulators

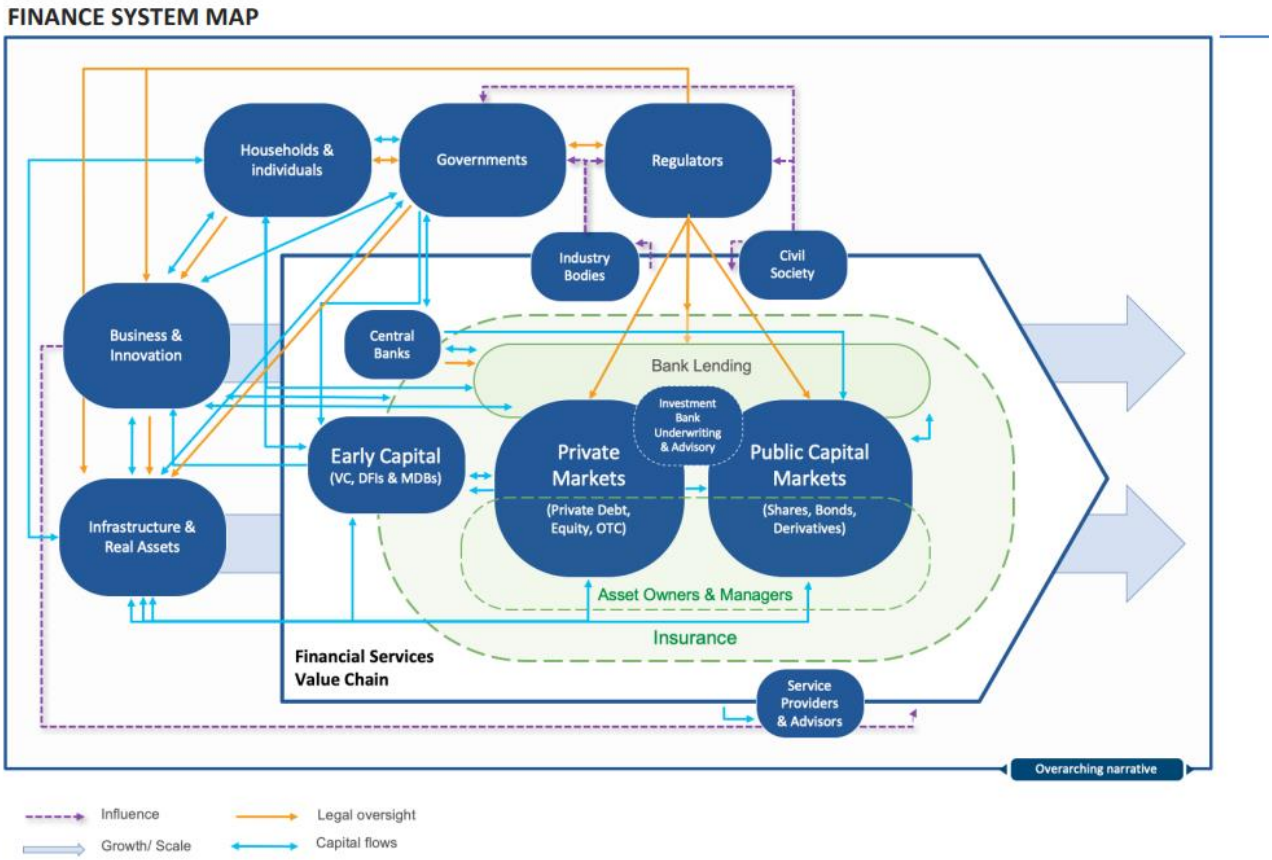
Civil society – NGOs, social movements and campaigns and community groups

Local government actors

Non-financial corporates & cities – multinational corporates, developers and projects, public private partnerships

Financial Institutions and actors

- **Central banks** – multilateral, national, subnational, networks
- **Banking & lending** – retail, commercial, non-bank, lenders, fintech
- **Investment** – asset owners, asset managers, banks, public funding, private equity, public listed equity, publicly issued fixed income, private debt
- **Insurance/underwriting** – retail, commercial, credit, reinsurers
- **Service providers & advisors** – consultants, rating agencies, data providers, industry associations, platforms, exchanges
- **IFIs, DFIs & Innovation funding** – development banks, government research and innovation funding, green banks, multilaterals



Levers of change

To achieve the Vison by 2030, we have identified the following key levers of change:

Addressing double materiality through assessing and disclosing impact risks. Enhanced dialogue between the water, regulatory and financial community on financial impacts of water security as well as the impact the financial sector has on water will bridge the existing materiality gaps. Pricing water is a key step to addressing double materiality. It will inform users about the economic value of the resource, so that their decisions take this value into consideration. It is a financing mechanism that generates revenues which can be used to maintain, renew, and extend infrastructure. Failure to recognize the economic and other values of water services is one of the factors that set in motion a vicious cycle of under-funding in water-related infrastructure and management activities (OECD, 2010).

Engagement with clients, policy makers and regulatory bodies should be guided by SDG 6 and the Valuing water principles. Through adopting and using a clear set of requirements towards companies they work with or plan to engage with, the financial sector will drive a change in water practices across a range of sectors and will require companies with a high-water footprint to value and act on water as a financial risk. Making such requirements an inseparable part of the decision-making process of FIs will drive the necessary large-scale change to better protect water systems. In addition to this, FIs can use their position as a key stakeholder to engage with policy makers and regulatory bodies and advocate for stronger regulation and policies that enable and drive the sector transformation in the real economy.

System transformation tools & capacity building are essential to the transition. For the financial sector to succeed in this transformation, new market norms, taxonomies, scenarios, mechanisms and tools for water security and resilience need to be set in place. There is a need for infrastructure and action to incentivize capturing material water-related data through disclosure. Governance, oversight and/or coordination mechanisms to promote integrity, accountability and harmonization of targets, commitments, and standards across financial systems. Systems and sector alliances to foster the sharing of best practices, understanding of possible water-related risks, solutions, and opportunities, and lifting of barriers to progress.

Existing assets and finance must be used as a leverage in transforming the system. Improving timely asset management to reduce operational inefficiency, sound capital expenditure (CAPEX) planning, seizing opportunities to improve economies of scale and targeted allocation of public subsidies. Combined with creating and maintaining incentives for performance.

Long-term strategic planning & resilient investments will optimize future investments and will ensure that assets deliver anticipated benefits over their operational lifetime and avoid premature obsolescence or costly retrofitting in the future, while tackling the tragedy of horizons issue. Such an approach would also help to secure a stable flow of investment opportunities and returns for investors, as in the OECD's Financing a Water Secure Future policy highlights. There are increasing opportunities for investing in urban development, delivery of water and sanitation services, the management of water resources and water-related risks. However, there is a need to strengthen the enabling environment for investment, to support the development of sustainable finance and boost interest in water investments.

Closing the financing gap for water related investments through mobilizing additional sources of funding and finance from various public and private sources. Governments can enable this through employing variety of economic and financial policy instruments. Multilateral development banks can help reduce and share investment risks which will attract more investors as currently commercial financing covers only 6% of total expenditure on water supply and sanitation.

Milestones towards 2030 (draft examples)

What milestones should be set and met by each actor group on our way to delivering on the vision by 2030?

Actor	2023	2025	2027	2030
Policymakers and regulators	Mandate water-related reporting for all companies and financial institutions. Improve the understanding of possible water-related credit risks for sovereigns and municipalities.	Boost demand for green bonds by implementing "green bond mandates" for domestic funds and promote the expanded use of labelled green bonds for financing climate - aligned water projects and assets.	Have in place a system that tracks whether requirements are followed by companies.	Efficient mechanisms for pricing water are already in place and widely used.
Central banks	Exercise supervisory/prudential authority to require financial institutions to assess and disclose material water-related financial risk exposures consistent with TNFD recommendations. Commit and take immediate action to integrate water-related risks into monetary frameworks and models to account for water impacts on macroeconomic outcomes.	Require annual water risk stress tests of financial institutions under supervisory/prudential authority.	Continue to require and review annual water risk stress tests of jurisdictional financial institutions under supervisory/prudential authority. Update research on systemic water-related risks to financial markets and corresponding recommendations to support a smooth and just transition.	
Banking & lending	Disclosure of and accountability for financed water impacts from financial institutions is normalised amongst the world's largest publicly listed financial institutions. Financial institutions revise protocols and incentives to create an enabling environment for innovative green / nature - based solutions.	Support 30+ countries to access climate finance for water - informed National Adaptation Plans and integrated flood and drought management policies and measures (Global Water Partnership's GCA Water Action Track commitment)		
Investment	Institutional investors publicly support a campaign to end industrial water pollution and catalyse water reuse and recycling. Scale up public -private investments in water reuse/ water renewal and efficient infrastructure.	Amount of money invested in ecosystem restoration through landscape scale initiatives has doubled since 2021. 100 Water Funds are established around the world. Investors are setting science - based targets for water across their portfolios.	Investments in sustainable development enterprises are fully integrated into landscape initiatives that enhance water resiliency and restore wetland ecosystems alongside restoring agricultural productivity.	Water benefits are recognized and funds are mobilized, investments boosted and good quality resources are available to the water sector.

Insurance & underwriting		Commit to risk screening of investment portfolios, specifically in terms of water risks.		
Service providers & advisors	Engage with and support landscape restoration partnerships that will enhance water resiliency through systems approaches, bringing financial returns alongside returns for nature and society.	The credit rating of the world's most impactful companies is based upon corporate efforts to improve water security and prevent water -climate -risk related conflict.	World's most significant stock exchanges include corporate water disclosure in listing requirements.	
Civil society	Water community to engage with finance supervisors to bridge the data and methodological gaps that may prevent a quick uptake of risks assessment by the financial system			

Developing the Pathway

The finance sector is complex and dispersed. We therefore need your input to formulate a clear and shared vision by 2030, the levers that will help us get there, and key actions and milestones to be met by each financial sector actor. We will reflect on the feedback received at the 9th Roundtable on Financing Water and as well as an online survey that captures the essence of the Pathway.

We will dive deeper into the specific elements where there could be positive impact and establish clear actions that will lead to the final goal of transitioning the financial system and financing the transition to a water secure world. We will then assign the different elements and actions to the relevant financial actors to compile a comprehensive table of milestones (as the example above). The Pathway will have a dedicated section showcasing the financial sector's progress in the transition to a water secure world. Capturing some best practices and sharing existing knowledge to inform the readers and facilitate capacity building among the financial sector.

We will continue our engagement with the financial sector and other relevant stakeholders to consult and test our assumptions and create a pathway that gives clear, vetted and timebound guidelines for the involved actors. **If you would like to comment on this draft or share any thoughts and suggestions for further development of the pathway, please do not hesitate to reach out to Teodora Kaeva, the leading manager of this project, at Teodora.kaeva@cdp.net.**