Financial Institutions are Valuing Water

How the financial sector is responding to the water crisis

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Foreword

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Water underpins all of our social and economic activity. We depend on a reliable, clean supply of drinking water to sustain our health. We need water for agriculture, energy production, recreation, manufacturing and to preserve our ecosystems. Without water our food production stops, cities cease to function, greenery turns to desert and economic activity grinds to a halt.

The Valuing Water Initiative is a Dutch government programme that works with partners worldwide to rethink how we understand, value and manage water. It aims to increase awareness of the many values of water and share lessons on how to identify the value of water in its numerous competing uses between communities, cities and countries.

A key part of this mission is highlighting the value of water in sectors where it has not traditionally been a priority. As this report shows, the availability, quality and good governance of water resources are fundamental to economic performance and leading financial institutions are increasingly recognizing the double materiality of water risk across financial portfolios.

While this growing awareness is welcome, the report's findings also suggest that water remains an undervalued resource in the sector. Financial actors have a key role to play in the transition towards a more sustainable, water-secure economy and it is essential to recognize frontrunners – such as those FIs that establish water-related investment criteria and maintain board-level oversight of water issues.

Greater disclosure of both the risks and opportunities that water poses to financial portfolios is an important step in this transition, and we are pleased to have supported CDP and partners in extending water disclosure to the financial sector for the first time.

Executive summary

The full digital version of this report can be read here:
Financial Institutions are Valuing Water - CDP

Key findings

1 **For the first time, financial institutions (FIs) were asked to disclose on water in CDP's annual global questionnaire**. 1,226 financial institutions were invited; 556 responded to questions about climate (45%) and 275 (22%) on water. Respondents represent a combined market cap of US$3.7 trillion.

2 Water impacts and risk exposure of portfolios appears to be an under-prioritized issue for FIs with only 93 of the 275 respondents undertaking water-related risk assessments, only 40 assessing portfolio impacts on water security, and just 48 reporting exposure to risks. The maximum potential impact due to water risks from 22 FIs was US$6.4 billion.

3 Despite the low perceptions of risk exposure, 118 respondents indicated they have board level oversight of water issues, and 72 respondents report that they set water-related requirements that their clients/investees must meet. A further 79 respondents are aiming to implement such criteria in the next two years.

4 This level of action may be driven by a range of other factors, in particular, the opportunities to be seized from tackling water insecurity. Indeed, while 56 respondents report such opportunities, just 23 report that they anticipate generating up to **$203 billion in potential value**.

We wish to thank those institutions that took the time to respond in 2022. These institutions are early adopters in water disclosure. The aim of this summary is to shine a light on the actions they are taking, encourage them to continue and compel others to join in.

Read through the full findings and analysis

The role of financial institutions in addressing the water crisis

17 countries

withdraw more than 80% of their available supply every year[1].

108 central banks

focused on climate and environmental risk management, have released reports on the materiality of nature to FIs[2].

US$5.6 tn

in potential economic losses by 2050 from storms, floods, and droughts[3].

US$392 bn

of financial impact reported by companies due to water risks, such as shortages and pollution[4].

The global economy is deeply dependent on water and the risks are material to financial institutions.

Achieving a water-secure future will require a complete transformation of our global economy. The financial sector has a critical role in achieving this future. Financial institutions can offer unique incentives to accelerate this transformation of the real economy by ensuring their lending, investment and insurance underwriting practices drive water users to value water.

In order for financial decisions to deliver positively against our global water goals, impacts of a changing environment upon financial performance and the impacts of financial activities on water environments, are important and material considerations. In other words, a double-materiality approach should be adopted in all aspects of water-related assessments, data collection, tool developments, regulatory responses and standard development.

Under one materiality lens, changes in the availability and quality of freshwater pose a financial threat to the financial sector. The second materiality lens reveals the financial sector as one with a critical impact on the world's rivers, lakes, aquifers and streams.

Financial institutions are polluting and deteriorating water systems through the business activities that they finance and enable, and thus further exacerbating the water crisis. Water Watch, CDP's Water Impact Index, details the negative impacts that various industries and sectors have on water resources, which are enabled by the financial sector. This includes enabling agribusinesses to pump ever increasing amounts of non-renewable groundwater, tailings dams to be constructed at the heads of free-flowing rivers and chemical, apparel and pharmaceutical companies to release toxic pollution, much of which is carcinogenic; posing a real and present danger to human health. These multiple impacts result in economic costs for society at large, which leads to social inequality and a financial burden for taxpayers. As such, impacts that companies have upon freshwater resources are important, material considerations for FIs.

1 World Resources Institute (2020). https://www.amfori.org/news/trend-fight-water-accelerates
2 Network for Greening the Financial System, https://www.ngfs.net/en/liste-chronologique/ngfs-occasional-papers?year=2021
3 GHD (2022). Aquanomics. https://aquanomics.ghd.com/
4 CDP (2023) Global Water Report: https://www.cdp.net/en/research/global-reports/global-water-report-2022

Clearly, it is in the interest of FIs to avoid and/or mitigate adverse water-related impacts associated with their financial practices. There are two main avenues through which they can do this:

- Mobilizing capital and scaling up: financing the water sector by investing in water infrastructure, water technology, sanitation services, data and monitoring systems, and other water-related projects necessary to supply and treat water for farmers, industries and households.
- Reducing water-related impacts, dependencies and risks of financial beneficiaries by undertaking due diligence, establishing and reporting water-related targets and covenants across all lending, investment, insurance and underwriting activities across multiple sectors.

Through their financial practices, FIs can drive various water users to use water wisely, avoid pollution, and to promote reuse. FIs 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.

The introduction of CDP's annual water-related disclosure mechanism for financial institutions is aimed at catalyzing this change within the sector and we are greatly encouraged by the results from the first year.

Pathway to a water-secure world[5]

Elements	What	How
Foundations	Build knowledge base	Assess risks, opportunities, dependencies and impacts on water security.
Strategy	Implement ambitions	Align business strategy, long term objectives, financial planning and policy with achievement of these ambitions.
Engagement	Collaborate with stakeholders	Engage stakeholders including clients/investees, industry alliances, governments, civil society.
Targets	Set targets	Develop bold, ambitious targets that are time-bound and science-based.
Governance	Build capacity and accountability	Ensure board oversight, management processes, team capabilities, incentives, and expertise are in place.
Disclose	Transparency on progress against objectives	Disclose the progress of targets and actions through CDP, demonstrating leadership and accountability, and scaling up action amongst peers and clients/investees.

5 Building on GFANZ and WWF's guidance on integrating nature in transition plans (for water) (2023): https://www.wwf.org.uk/our-reports/wwf-nature-transition-plans

Action is building

118 FIs

indicated they have board level oversight of water issues. Of these, 33% indicated that they have at least one board member with competence on water-related issues.

97 FIs

reported that they have existing products and services that enable their clients to mitigate water insecurity.

Whatever the reasons, action to better understand and address the issues surrounding water security is being spearheaded by a group of leading FIs. Below we outline the four action areas currently receiving most attention.

Building governance

Governance structures that drive finance and resources towards water security by enabling accountability and incentives to achieve them is an overarching first step. The role of the board of directors and their ability to oversee water-related impacts, risks and opportunities is therefore essential. 118 respondents indicated they have board level oversight of water issues. Of these, 33% indicated that they have at least one board member with competence on water-related issues – a strong foundation for leadership.

Regionally, European-based FIs appear to lead the way in setting governance structures, followed by Asian-based FIs.

Building products

97 respondents reported that they have existing products and services that enable their clients to mitigate water insecurity with a further 63 planning to move in this direction in the next two years. The top product types offered were 'corporate loans' and 'listed equity', while the top activities financed, invested in, or insured by responding FIs related to water infrastructure. BBVA for example, incentivizes clients to reduce water footprints and improve their CDP water score through a new 'water footprint' KPI linked loan which is predominately targeted at clients with increased water-related risks.

105 FIs

either currently or plan to exercise their voting rights as a shareholder on water-related issues.

Building votes

105 respondents either currently or plan to exercise their voting rights as a shareholder on water-related issues. **HSBC Asset Management**, for example, has introduced a new policy in 2022 to vote against the chair or relevant board directors of companies on their nature watch list, which is based on third-party assessments of how companies are managing nature-related risks, including biodiversity and water. Canadian insurer **Sun Life Financial** voted for a shareholder proposal at the 2020 AGM of Pilgrim's Pride Corporation that requested a report on the company's reduction of water pollution. The proposal received 15% support.

Building expectations

150 respondents, including **Barclays, BNP Paribas and First Finance Holding Company** either already set water-related requirements that their clients/ investees need to meet or intend to do so in the next two years. 50 of these respondents require compliance with water-related criteria as a pre-requisite for doing business. **BNP Paribas**, for example, requires clients to comply with all applicable water regulations, engage with, or support, their suppliers to minimize negative water impacts, monitor and reduce water withdrawals and consumption, and reduce/ eliminate water pollution. If the institution becomes aware that a client operates outside the requirements of the policy, a dialogue will be engaged with the client to find an acceptable solution to improve the situation in a timely manner. If this dialogue is unfruitful, BNP Paribas may decide not to pursue any new business with such client and will place existing business under review or exclusion, taking into account existing contractual agreements.

108 FIs

reported that they engage in activities that could directly or indirectly influence policy, law, or regulation that may impact water security.

FI engagement and expectation setting on water issues doesn't stop with clients. 108 respondents reported that they engage in activities that could directly or indirectly influence policy, law, or regulation that may impact water security. Consider, for example, the 35 institutions that signed an open letter to Governments on the water crisis in March 2023.

Recommendations

CDP's findings highlight that action to stem the water crisis, manage associated water risks and seize opportunities within the finance sector is not only necessary but possible and already underway.

Financial institutions

Financial institutions need to map portfolio water impacts, set ambitious, measurable, and time-bound water-related targets to address these and publicly disclose progress.

Like those first-movers profiled in this summary, FIs that begin to engage with water impacts and dependencies stand to benefit across the board. Financial firms which act now will be better placed to manage incoming regulation, get ahead of the competition, and seek out billions of dollars of commercial opportunities, such as creating new products and services.

Policymakers

CDP calls on governments to implement comprehensive water disclosure requirements for companies and FIs.

The policy, regulatory and supervisory structures that dictate how capital is allocated within the financial sector are now starting to consider and embed nature-related risks, opportunities, and impacts[6]. The regulatory landscape needs to evolve with standards and voluntary initiatives setting the scene for comprehensive disclosure in order to fast-track water action.

6 https://www.ngfs.net/sites/default/files/medias/documents/statement_on_nature_related_financial_risks_-_final.pdf

Academics, civil society, philanthropists and standard setters

CDP calls for a strengthened enabling environment to guide FIs in meaningfully addressing financed water impacts, risks and opportunities.

While the action on display in this first year is encouraging, we cannot ignore the lack of action from the 951 institutions that chose not to disclose, nor the lack of action in some areas from those 275 institutions that did. CDP's dataset provides insights into why action is not happening and suggests that a deficit in water-related standards, guides, tools, definitions and data sets is stifling ambition and progress. If we are to accelerate the pace of change, those with the ability to plug these knowledge and resource gaps should do so.

With support from the Dutch Valuing Water Initiative (VWI)[7], CDP and partners Water Footprint Network (WFN)[8], Water Footprint Implementation (WFI)[9] and Mercer[10] worked over the past two years to design and implement a global disclosure mechanism that aims to baseline the current state of knowledge and action of FIs on water. It has been informed by the latest scientific insights, a range of global stakeholders and aligns with and goes beyond the Task Force on Climate-Related Financial Disclosures (TCFD). This report presents the first ever results from the CDP Financial Sector Water Questionnaire.

7 Dutch VWI initiative.
8 Water Footprint Network.
9 Water Footprint Implementation.
10 Mercer.

About CDP

CDP is a global non-profit that runs the world's environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with more than 740 financial institutions with over $130 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Nearly 20,000 organizations around the world disclosed data through CDP in 2022, including more than 18,700 companies worth half of global market capitalization, and over 1,100 cities, states and regions. Fully TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero carbon, sustainable and resilient economy. CDP is a founding member of the Science Based Targets initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative. Visit cdp.net or follow us @CDP to find out more.