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**Submission of input to the UNFCCC Standing Committee on Finance
2026 Forum on financing climate action in water systems and the ocean
On behalf of the Water Resilience for Economic Resilience informal working group**

Are we really addressing the concerns and the potential role of financial institutions when we discuss financing water systems for a resilient society?

When the water community talks about financing water, they mainly analyze the financial needs and financing deficits for water investments. They discuss the effectiveness of finance, the financing options and the barriers and enabling conditions for ensuring financing flows are directed to specific investments.

At the same time, financial institutions and regulators are increasingly engaging in a separate conversation that remains largely unfamiliar to the water sector. They are concerned about the level of exposure and vulnerability of their operations and portfolios to water related risks. Climate change is making water risk a macro-financial risk, not just an infrastructure challenge. For banks, insurers, investors and governments, the key question is no longer only how to finance water, but how unmanaged water risk threatens financial stability, sovereign creditworthiness and long-term socio-economic activities.

Organizations such as the Network for Greening the Financial System have been working on analyzing the financial materiality of physical risks, and regulators such as the European Central Bank are promoting the analysis of the level of exposure of financial organizations and taking this into account in their capital decisions. Central banks are increasingly incorporating water risks (scarcity, pollution, floods) into their capital and financial stability frameworks, viewing them as systemic drivers of credit, market, and operational risks for banks, impacting borrowers' ability to repay and asset values, with institutions like the European Central Bank (ECB) setting supervisory expectations for banks to manage these risks through scenario analysis and stress testing, recognizing that that climate and more broadly nature related risks amplify traditional financial risks across sectors (OECD 2025).

Dramatic decline in water availability and extreme hydrologic events such as droughts and floods can have important economic impacts within a country and throughout supply chains in other parts of the world. Financial institutions' portfolios are vulnerable to these risks and can benefit from water resilience. Beyond this, they play a crucial role not only in financing water-related projects but in steering capital toward water-resilient investments by adjusting/transforming their lending and investment practices.

Findings of Usman, González-Torres, and Parker (2025) confirm that extreme events have persistent effects on regional growth. Following a heat wave, regional output can fall by up to 1.5 percentage points in the following two years, and after a prolonged drought, the reduction reaches 3 percentage points in four years. This study illustrates how the

combination of lower agricultural productivity, reduced investment, and negative net migration weakens the productive base of the affected regions, amplifying the financial impact on households and businesses.

This is why water risk is now central to the climate-finance agenda. Climate-driven droughts and floods are among the main channels through which climate change affects economic output, inflation, and financial stability. The IMF (2024) has analyzed the macroeconomic consequences of droughts in different countries. The authors show that, beyond the immediate damage, droughts generate a “scarring effect” with losses in GDP per capita of up to 0.4% over a five-year horizon. The effect is even more severe when combined with additional shocks, such as energy or food price shocks. In these cases, water risks act as multipliers of inflation and macroeconomic instability.

The OECD (2025) estimates that, by mid-century, droughts could reduce potential growth in southern Europe by up to 0.6 percentage points per year. This scenario reflects not only losses in productivity and physical capital, but also the degradation of critical infrastructure such as dams and hydroelectric power plants, which has an impact on energy supply and business competitiveness. Taken together, these findings confirm that water stress has a cross-cutting impact on the productive system and, through financial channels, can become a systemic risk to economic stability.

In terms of financial stability, the impacts of water scarcity, droughts, floods and over-exploitation of water resources translate into risks that erode bank solvency. Reduced income in sectors such as agriculture, energy, and tourism increases credit delinquency; the depreciation of collateral assets, such as agricultural land, increases losses due to non-payment (LGD); and tensions in the insurance sector transfer uncovered risks to the banking system. In addition, fiscal pressure from lower tax revenues and higher compensation expenditures increases the vulnerability of sovereign debt.

Managing water and climate risk therefore requires not only more investment in water systems, but a transformation in how financial institutions measure, price and allocate capital in climate-vulnerable economies. Water is one of the most powerful but under-priced channels through which climate change threatens financial stability. Financial institutions are now being forced to respond.

In this context, we believe that this year’s SCF Forum on water and ocean systems should make space available within its programme, through a dedicated session, to address three interrelated questions:

- What are the financial impacts of water-related risks and how are financial organizations measuring them?
- What guidance can help manage these risks and what tools can help analyze the risks of specific operations?
- How can financial organizations support water resilience through their operational decisions?

To answer these questions the session will:

- Showcase the work of the Central Bank of the Netherlands on the exposure of the banking system to mortgages in the lowlands, and the analysis of the macroeconomic impacts of the Valencia Floods (DANA) carried out by the Bank of Spain and different financial institutions;
- Present the guidance prepared by organizations such as OECD and WWF on how the financial system can take into consideration the water-related physical risks, and;
- Discuss specific cases of the role of financial organizations for promoting water resilience, such as the new business and credit lines of the BBVA Bank in Spain.

The session should examine how sovereign credit rating agencies assess climate-driven water risks, focusing on who ultimately absorbs the financial losses from floods and droughts. This includes the role of insurance and reinsurance in limiting fiscal exposure. It will also explore the extent to which public compensation schemes and disaster-related investments create contingent liabilities for governments, which have direct implications for sovereign creditworthiness, bank balance sheets, and financial stability.

Finally, this conversation could be situated as one stepping stone in a series of conversations throughout the year that bring together climate, finance, and water professionals to support concrete action and stronger outcomes. This is directly related to a potential series of preparatory events that would lead up to the UN 2026 Water Conference in December in the UAE.

For further reference:

Water Resilience for Economic Resilience: <https://www.alliance4water.org/wr4er>

OECD's Embedding Water-related Risks in Financial Stability Frameworks: [Embedding Water-related Risks in Financial Stability Frameworks | OECD](#)

UK Government's Global biodiversity loss, ecosystem collapse and national security: https://assets.publishing.service.gov.uk/media/696e0eae719d837d69afc7de/National_security_assessment_-_global_biodiversity_loss_ecosystem_collapse_and_national_security.pdf

ECB's Nature at risk: Implications for the euro area economy and financial stability: <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op380.en.pdf?94694a07f4e73bcbcd5f59b75f9b8733>

NGFS's The Green Scorpion: the MacroCriticality of Nature for Finance: https://www.ngfs.net/system/files/import/ngfs/medias/documents/ngfs_occasional_paper_green-scorpion_macrocriticality_nature_for_finance.pdf

OECD's Global Drought Outlook: https://www.oecd.org/en/publications/2025/06/global-drought-outlook_28488e98.html



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