# Climate·Bonds·Connected
## Webinar Programme

## NGFS Reports: Central Banks & Climate Risk

**Friday 5th June 15:00 Paris / 14:00 London**

Climate Bonds Initiative

NGFS
Central Banks and Supervisors Network for Greening the Financial System

GARP | Global Association of Risk Professionals

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# Status Report
## On financial institutions ’ experiences from working with green, non green and brown financial assets and a potential risk differential

Network for Greening the Financial System

# AN OVERVIEW OF INDUSTRY'S EXPERIENCES WITH "GREEN" ASSETS AND THEIR RISK PROFILE

- **The report highlights the findings of a survey conducted in Q4 2019 among banks and insurance companies around the globe**
- **Objective of the survey:** try to detect a potential risk differential between green, non green and brown assets by analysing data and case studies from individual institutions.
- **Methodology:** a questionnaire with qualitative and quantitative questions was sent to financial institutions. Answers were received in Q4 2019. **49 banks and 5 insurance companies contributed to the survey on a voluntary basis**.
- **Overview of :**
  - **Individual practices** implemented by financial institutions to keep track of the climate and environment-related risk of some assets (implementation of a taxonomy or internal classification, integration into risk monitoring…)
  - **Methodologies** developed to quantify and monitor this risk
  - **Challenges** encountered and way forward

# NO STRONG CONCLUSION YET ON A RISK DIFFERENTIAL BETWEEN GREEN, NON GREEN AND BROWN ASSETS

- **Different taxonomies or internal classifications** are used to define the "greenness" of an asset, mostly on a voluntary basis.
- **The majority of the sample did not perform dedicated climate risk analysis** to identify a potential risk differential.
- **10% of the respondents provided results from a backward-looking analysis** purely related to green and/or brown factors, and then only for a subpart of the whole portfolio.
- Risk analysis performed ex post gave **diverging results**.

➢ **There is too much heterogeneity** around the individual definitions, methodologies and results reported by the respondents to be able to conclude on a risk differential

# SOME POSITIVE TRENDS REGARDING CLIMATE AND ENVIRONMENTAL-RISK MONITORING OF INDIVIDUAL INSTITUTIONS

- **The tracking of climate and environment-related risks is a quickly growing trend among the respondents**:
  - Most of the respondents who implemented a taxonomy or classification to track green/brown assets did it in the last 2 years
  - Only 15% of the respondents had not implemented any classification yet
  - A vast majority of those is considering adopting one in the future.
- **Most respondents already have operational commitments describing how to take climate risk into account in credit assessments**, e.g. in the form of sector limits and/or steering documents.
- **Developing forward looking methodologies may help to better assess the specific risk of green and brown assets** and allow for better monitoring and pricing of climate and environment-related risks.

# CHALLENGES ENCOUNTERED BY THE RESPONDENTS

- **Lack of a common “green” or “brown” taxonomy**
- **Difficulty to assess loans granted for general purpose**
- **Lack of historical data** to conduct backward-looking analysis/ **need to use forward looking methodologies** on a longer time frame
- **Costly process** (framework design, staff training, IT adaptation, etc.)
- **Some doubts on the added value of tracking the specific risk profiles of green or brown assets** for institutions in the first stages of their “green” operational commitments.
- **Level playing field** : without uniform regulatory requirements, forerunning institutions may suffer from a competitive disadvantage

# TENTATIVE CONCLUSIONS AND HIGH LEVEL MESSAGES TO FINANCIAL INSTITUTIONS

- **The necessary conditions for tracking the risk profile of green, non-green or brown assets are not yet in place in all but a few jurisdictions**. The adoption of a common green (and brown) taxonomy will be key to solve this issue.
- The magnitude of **climate and environment-related risks is such that they should be further integrated into financial institutions´ credit risk assessment**:
  - Institutions should not overlook climate-related risks in their existing risk management framework
  - Forward looking methodologies should be used more widely. They will be fostered by the work on scenarios done by the NGFS

# Guide for Supervisors

## Integrating climate-related and environmental risks into prudential supervision

# Guide for Supervisors

## Integrating climate-related and environmental risks into prudential supervision

- Based on a **survey amongst 34 NGFS members,** further input received from NGFS members and other work done by supervisors outside the network.
- The Guide sets out **five recommendations** for prudential supervisors to integrate climate-related and environmental risks into their work
- The recommendations are **illustrated with practices from supervisors from all over the world**
- Focuses on **banks and/or insurers supervisors.** Its content could also be relevant to the supervision of other financial players.
- The **recommendations are non binding**. Aim is to offer supervisors the **inspiration needed to accelerate their own efforts** in this area, while giving them the flexibility to accommodate their own specific needs, tailor actions to their mandates and make progress at their own pace.

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# Guide for Supervisors

Integrating climate-related and environmental risks into prudential supervision

## 5 recommendations

**1.** Supervisors are recommended to **determine how climate-related and environmental risks transmit** to the economies and financial sectors in their jurisdictions and **identify** how these risks are likely to be material for the supervised entities.

**2.** Develop a clear **strategy**, establish an **internal organisation** and allocate adequate **resources** to address climate-related and environmental risks.

**3.** **Identify the exposures** of supervised entities that are vulnerable to climate-related and environmental risks and **assess the potential losses** should these risks materialise.

**4.** **Set supervisory expectations to create transparency** for financial institutions regarding the supervisors' understanding of a prudent approach to climate-related and environmental risks.

**5.** **Ensure adequate management** of climate-related and environmental risks by financial institutions and **take mitigating action** where appropriate.

# MAIN TAKEAWAYS

- Examples show that **supervisors have stepped up** - A lot of progress has been made worldwide
- **Journey** has been as important as **the destination**

- **Main challenges**
  - **lack of data and methodologies** for quantifying risks and calibrating prudential requirements
  - **lack of a risk-oriented taxonomy** or common definition of “green” and “brown” assets and, as a result, lack of evidence of a risk differential between “green”, “non-green” and “brown” assets.
  - The insignificance of risks stemming from climate change and the energy transition in the available **historical data**, as well as the **reliance on backward-looking models** pose significant analytical challenges.

# NEXT STEPS

- **Capacity building and knowledge sharing within the NGFS membership** will contribute to some of the necessary efforts - continue to leverage and update the best practices identified

- **NGFS will look further into**
  - the necessary **metrics** to enable supervisors to improve climate-related and environmental risks assessments.
  - the **transmission channels** through which environmental risks materialise as a source of financial risk.

***We aren't there yet, but - thanks to your efforts – we are getting closer every day.***

# GARP's Second Global Survey of Climate Risk Management

**Figure 1: Geography of Operation and Climate Risk Assessment**


- 71 firms with significant scale and global footprint
- Provides a great snapshot of financial firms' climate risk management capabilities

Sample:
Assets on balance sheets of $42 trillion; AUM $36 trillion
Market capitalization of $3.8 trillion

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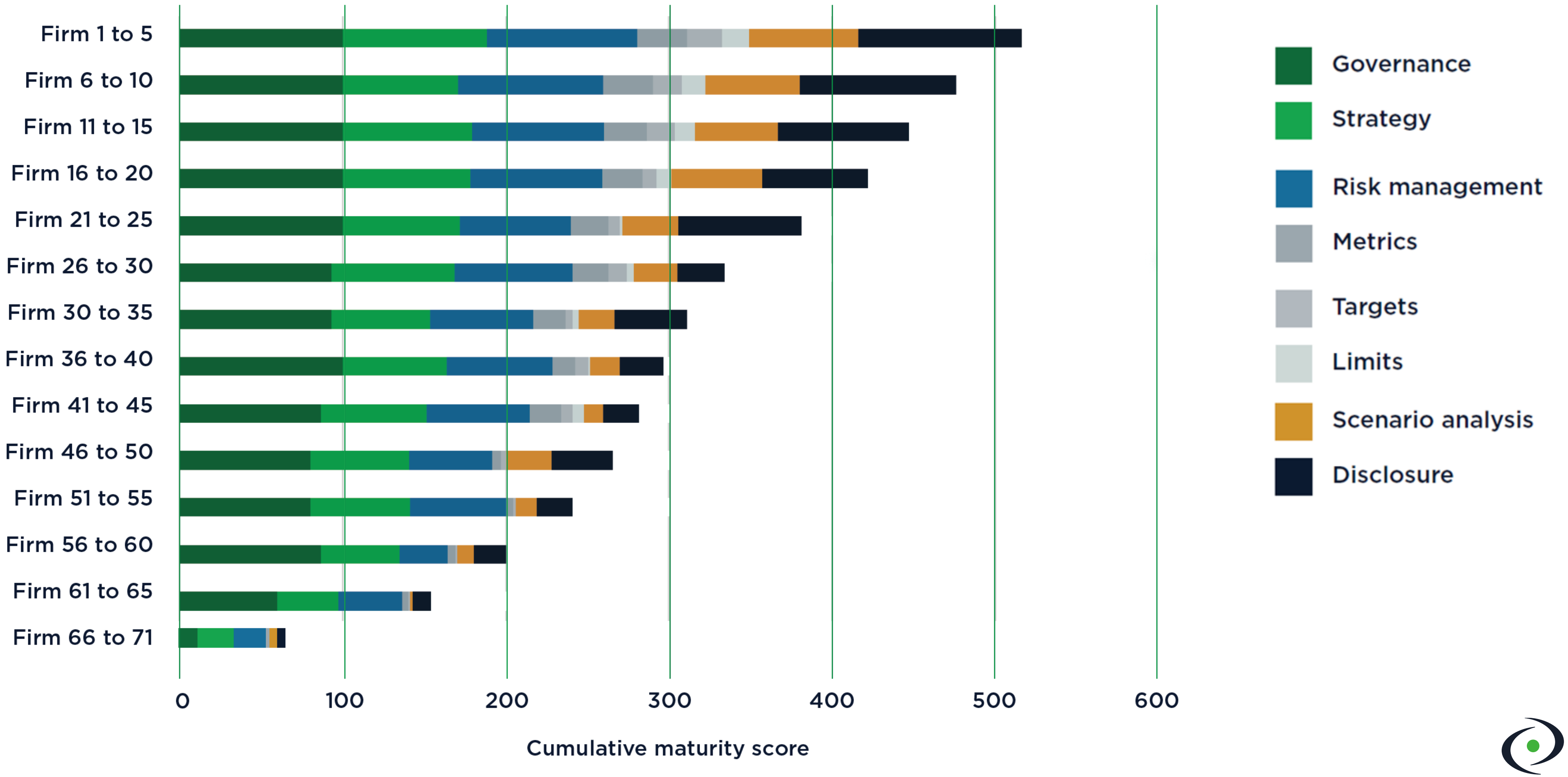
# The survey looked in depth at TCFD themes

| Governance | Strategy | Risk Management | Metrics, Targets and Limits | Scenario Analysis | Disclosure |
|---|---|---|---|---|---|
| Are the board and senior management engaged? | Has the firm assessed risks and opportunities? | Is climate risk integrated in day-to-day risk management? | Does the firm use metrics, targets and limits? | Does the firm use scenario analysis? | What is disclosed, and is it in line with TCFD? |

# There is a wide distribution of climate risk management practices



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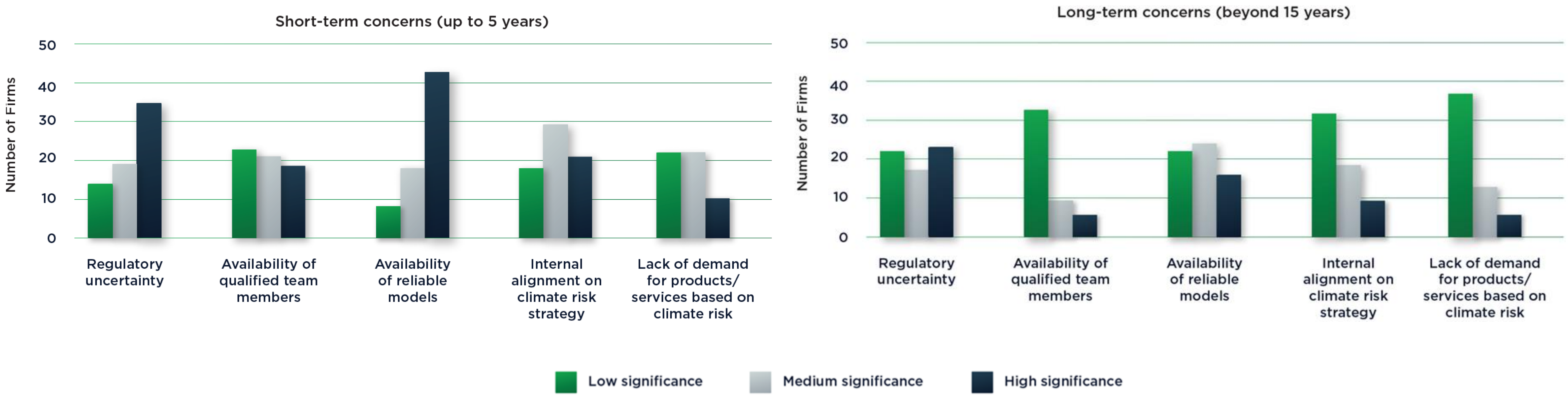
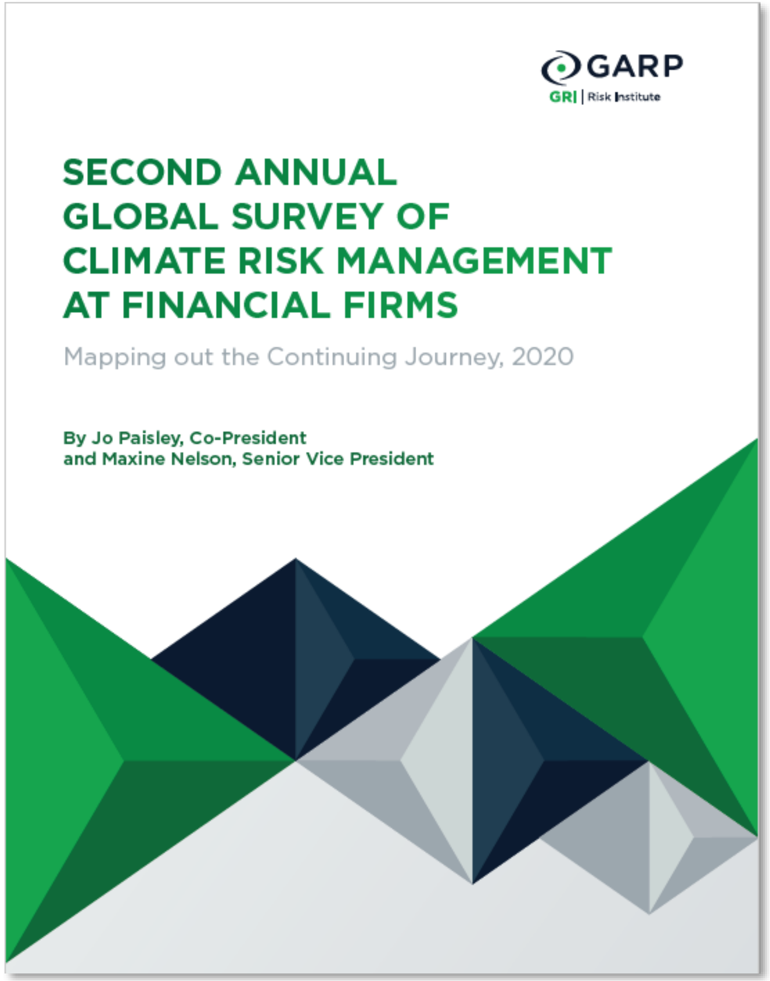
# Barriers and challenges expected to ease



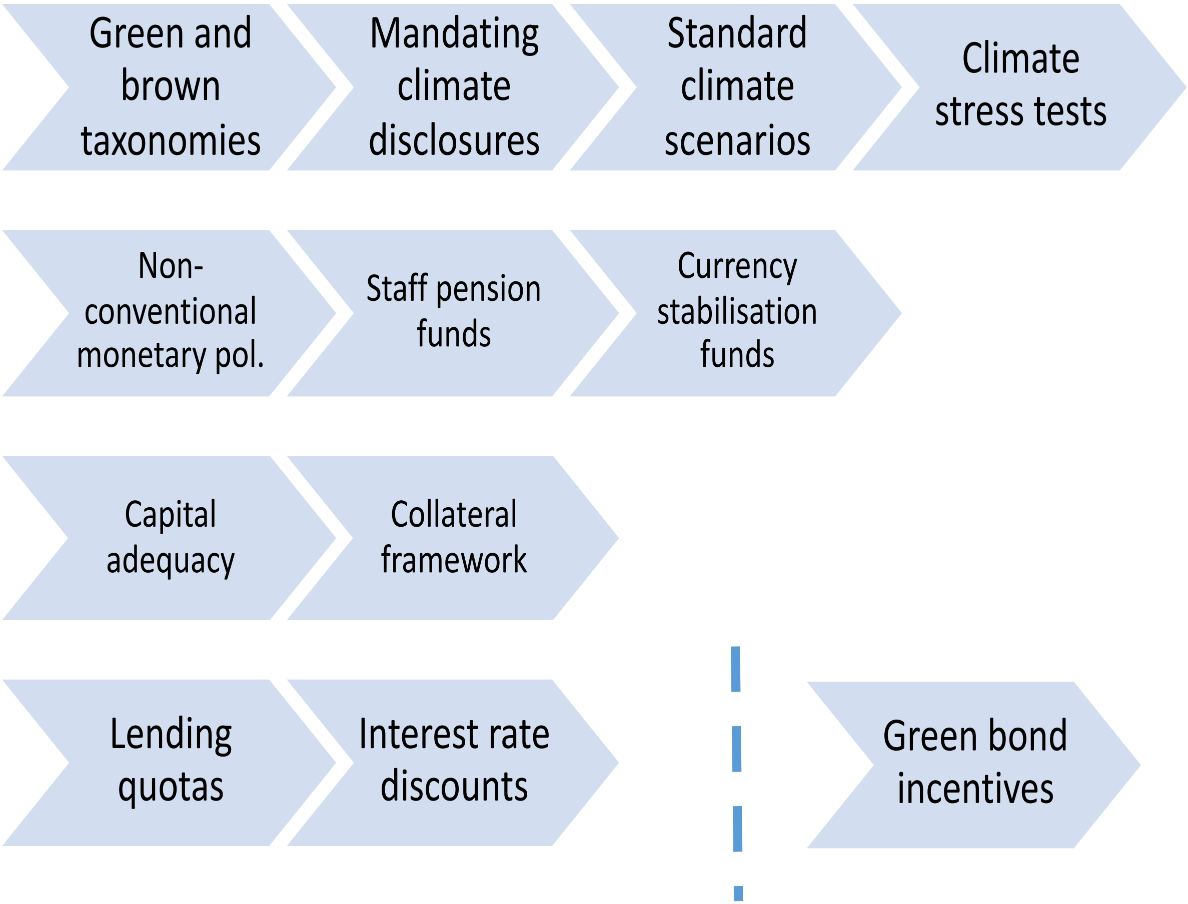
# Firms are on a journey … as are supervisors



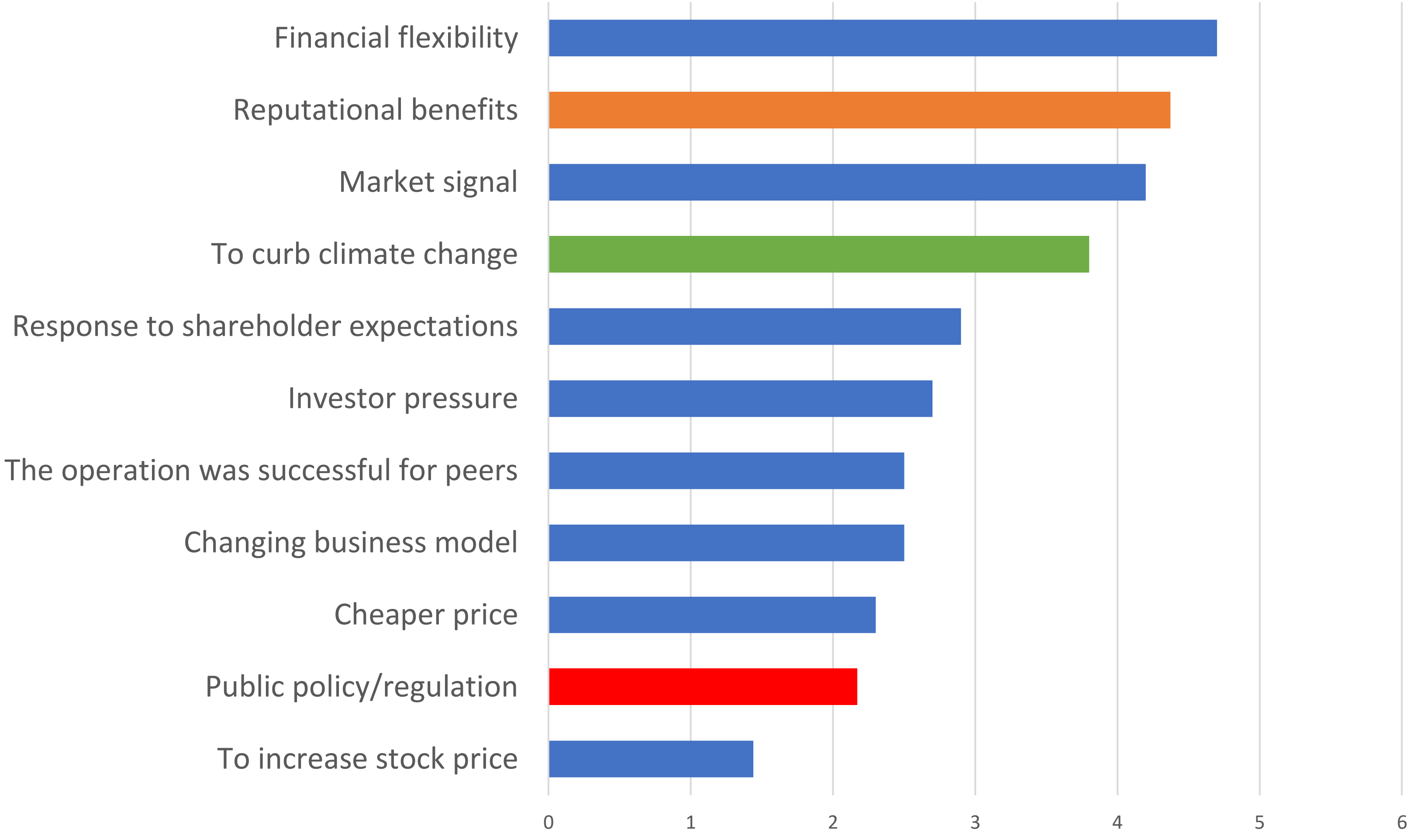

- It starts with the board
- Firms have to decide how to set up their climate risk functions
- Practically all of these firms think climate risk is improperly priced
- Scenario analysis still seems to be the hardest area to crack – be careful on harmonisation/coordination
- This is not just about capital – pricing, product development and business strategy are all critical
- There is a real need to build capability and awareness

https://climate.garp.org/insight/second-annual-global-survey-of-climate-risk-management-at-financial-firms/

# Toolkit of policies at central banks disposal



# Considerations when issuing a green bond? (1 to 6)



# Key Reports

NGFS

[Status report on financial institutions' practices with respect to risk differential between green, non-green and brown financial assets and a potential risk differential]

[Guide for Supervisors: integrating climate-related and environmental risks into prudential supervision]

GARP

[Second Annual Global Survey of Climate Risk Management at Financial Firms]

Climate Bonds Initiative

[Greening the Financial System: Tilting the Playing Field: The Role of Central Banks]

[Green Bond Treasurer Survey 2020]

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