BANQUE DE FRANCE

EUROSYSTÈME

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The role of finance: Anticipating climate risks, financing transition opportunities

Closing session: Speech by François Villeroy de Galhau

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Ladies and Gentlemen,

It is a great pleasure to be here to conclude this fourth edition of Climate Finance Day. This event gives a concrete picture of what I like to call the "**powerful coalition of the willing**". Each and every one of us – public authorities; academics, NGO's and think tanks; corporates and financial institutions – have a part to play in this coalition. It is a shared challenge that no one can tackle alone, and you have worked during these last three days to bring tangible solutions to quickly and effectively finance the transition.

Paris, chère Madame la Maire, has been a driving force committed to translating momentum into concrete action. Let me mention three key milestones: the COP 21 back in 2015, the "One Planet Summit" in December 2017, and this fourth edition of Climate Finance Day.

To better address concretely the financial risks stemming from climate change, the Banque de France initiated a **Network for Greening the Financial System (NGFS)** at the One Planet Summit, with eight founding members.[i] In less than one year, we have been joined by 13 other members[ii] and five observers[iii] from the five continents. They work together with great energy and enthusiasm.

In my remarks today, I will (I) take stock of the NGFS' achievements and then outline the decisive steps that are still ahead of us in order to (II) anticipate climate risks and (III) seize opportunities.

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I. The NGFS' first achievements

As highlighted by the winner of the 2018 Nobel Prize in economics, William Nordhaus, although "*there is substantial uncertainty about the path of climate change and its impacts* […] *this does not reduce the urgency of taking strong climate-change policies today.*[iv]"

Tackling climate change to "prevent the airplane from crashing" is first and foremost the responsibility of appropriate public policies in energy – as announced yesterday for France –, transportation, housing or – yes – taxation and carbon pricing. Finance cannot substitute them, but finance can help; and as central bankers and supervisors, we are determined to help. I would even say that this challenge is our "new frontier", comparable to the financing of growth and major infrastructures in the 19th century or the management of great financial crises in the last 100 years.

The progress report of the NGFS, released in October is hence an important step. Indeed, for the first time, this coalition of the 21[v] willing central banks and supervisors, has unanimously agreed that climate-related risks – as a source of financial risk – are within a central bank's mandate. The NGFS will not stop there and next year will publish its first comprehensive report, which will provide – on a voluntary basis only – policy recommendations for central banks and supervisors. This will take place at the upcoming NGFS Conference, at the Banque de France in Paris, on 17 April 2019: you are all most welcome!

To prevent the airplane from crashing, we can help by **shedding light on climate risks** in order to take accurate and timely decisions, and by seizing opportunities while **aligning incentives and mobilising capital**.

II. Anticipating climate-related risks

1/ Our first priority should be the disclosure of **existing exposures** in the financial sector, what I call "**the snapshot of risks**". The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), chaired by Mr. Bloomberg with sponsorship from the Financial Stability Board (FSB), have been groundbreaking as they provide a practical framework allowing companies to disclose their climate-related financial risks. However, an accurate and consistent vision of the risks requires a wider implementation of the TCFD's recommendations.

Significant room for progress remains in this area. To enable markets to price risks, we need comparable metrics – thanks to a common taxonomy – and better access to higher quality and more consistent data. I therefore fully support the work of the Technical Expert Group on Sustainable Finance of the European Commission which is concretely developing a taxonomy; our first NGFS workstream is also working in this field.

We should then gradually move towards **compulsory transparency** based on a “comply or explain” principle. Article 173 of the French Energy Transition Law – as it sets the Environmental Social Governance (ESG)-Climate approach as a new market standard – could usefully serve as a reference studied at the European level.

2/ Beyond the "snapshot of risks", the NGFS is working on a "**video of risks**", with long-term forward-looking stress tests to assess the dynamic effects of climate change on the economy and financial stability. The NGFS is currently developing economic scenarios based on climate change that could be used to conduct stress tests. Meanwhile, the ACPR has conducted a survey on banks and insurance companies to evaluate how they integrate physical and transition risks in their risk management. The results will be published by early 2019. They will be a good point to assess the progress made so far by the industry towards taking both risk factors into account. I would at this stage suggest caution on some NGOs’ analyses concluding that French banks have a “fossil energy bias”. Their large exposures to the oil and gas sector have indeed decreased between 2015 and 2017. This survey will also be valuable as inputs in designing the new framework needed to perform stress-test exercises and assess climate risk across the French financial system as a whole.

III. Financing transition opportunities

Like any good pilot, we want our plane to “gain some altitude”. And our goal here is not only to manage climate change-related risks, **but also to align incentives to make sure the transition is adequately financed**.

As time goes by and our ability to achieve a 1.5 to 2°C scenario is being seriously challenged, the amount needed to finance the transition is increasing steadily. This **quantitative challenge** is linked to the massive investment required to promote further development of technologies, notably carbon capture and storage and electricity generation from renewable sources. The amounts at stake vary, but as an illustration, the last Intergovernmental Panel on Climate Change (IPCC) report, published last October, estimates that until 2050, the energy-related mitigation investments to limit warming to 1.5°C reach USD 900 billion per year[vi]. The needs are so considerable that public financing alone will never be sufficient. But, per year this amount represents less than 1% of the 2017 gross world product. The burden is a heavy one, but it is far from insurmountable if we join forces. Let me turn to the private sector before coming back to central banks.

1 / Fortunately, the private sector is already showing a growing interest in green finance. I could cite many examples, including the sharp rise in the **global climate-aligned bonds market** which reached on outstanding amount of USD 1.45 trillion[vii] in 2018 or the success of the issuance of France's first green sovereign bond in January 2017. All this looks very promising… but it is still insufficient. The success of the transition will also depend on our ability to broaden the sources of financing: we should not rely solely on green bonds. We also need more green loans, and more green financing in general, accessible to individuals, SMEs and start-ups.

Mobilising this capital raises also some **qualitative challenges.** An orderly scaling up of green finance requires keeping markets away from green washing practices. The emergence of a new ecosystem of financial "good products", such as green, social, impact or Sustainable Development Goals (SDG) bonds would appear to be great news. But we should be cautious not to create a confusing diversity of definitions that could undermine the reputation of green markets and impede progress. An EU-wide standard based on high level common principles regarding the management of the funds and impact assessments, articulated with a common green taxonomy is critical to protect market integrity. It would certainly make sense to build, notably on the two most widespread standards: the Green Bond Principles (GBP) and the Climate Bond Initiative (CBI).

2 / Central Banks must also send out the right signal and **lead by example** in their investment and disclosure policies. We at the Banque de France have adopted in March this year a **Charter on Responsible Investment** for the management of our own funds and our pension portfolios: this means allocating them to socially and environmentally responsible investment funds. With respect to disclosure, we are going to disclose in **March 2019 the climate-risk exposures of our own funds and pension portfolios.** We are also working to adopt in the near future a TCFD-like reporting which would fit the specificities of central banks.

Regarding the role of monetary policy, some voices have been calling for a "green quantitative easing". But monetary policy has to be broad based and remain neutral to ensure proper functioning through its transmission channels; it cannot be targeted towards achieving specific social or sectoral impacts. However, this does not preclude the Eurosystem from buying green assets when they fall in the remits of the eligibility criteria of its purchase programmes. For instance, the ECB currently holds around EUR 79 billion[viii] of eligible green universe bonds from both the public and the private sector, which is already significant.

It does not mean though that monetary policy should ignore the question of climate change. Within our price stability mandate, I really believe further analytical work is needed to better understand the medium to long-term impact of climate change on intermediate monetary policy objectives and ultimately on our monetary policy strategy. To this end, a substantial research agenda remains before us and I hope the NGFS can play a role in helping to bridge the "knowledge-gap" in that area. In addition, from an operational perspective, if evidence shows that transition and physical risks have an impact on the risk profile of certain assets, central banks should draw a logical conclusion and incorporate these financial risks in their collateral framework.

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I would like to conclude with the message that Paul Romer gave during his Nobel Prize speech: “Humans are capable of amazing accomplishments if we set our minds to it.” On climate-related risks, in less than one year, central banks and supervisors have accomplished concrete steps to mainstream green finance in all their activities. Notwithstanding the political progress we would all wish for at international level, we are determined to follow our “flight plan” as financial authorities. Thank you for your attention.

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[i] Banco de Mexico, Bank of England, Banque de France/Autorité de Contrôle Prudentiel et de Résolution, De Nederlandsche Bank, Deutsche Bundesbank, Monetary Authority of Singapore, People’s Bank of China, Swedish Finansinspektionen.

[ii] BaFin, Banco de España, Bank al Maghrib, Bank Negara Malaysia, Bank of Finland, Banque centrale du Luxembourg (BCL), Banque nationale de Belgique (BNB), EBA, European Central Bank (ECB), Japan FSA, Oesterreichische Nationalbank (OeNB), Reserve Bank of Australia, Reserve Bank of New Zealand.

[iii] Bank for International Settlements (BIS), European Bank for Reconstruction and Development (EBRD), OECD, Sustainable Insurance Forum (SIF), World Bank (Group) + World Bank (IFC/SBN).

[iv] William D. Nordhaus, “Projections and uncertainties about climate change in an era of minimal climate policies”, NBER WORKING PAPER SERIES, **2016**.

[v] 8 founding members plus 13 new members (excluding 5 observers).

[vi] Intergovernmental Panel on Climate Change, **2018**.

[vii] Climate Bonds Initiative, “Bonds and climate change the state of the market”, **2018**.

[viii] Roberto A. De Santis, Katja Hettler, Madelaine Roos and Fabio Tamburrini, “Purchases of green bonds under the Eurosystem’s asset purchase programme”, ECB Economic Bulletin, Issue 7/**2018**.