# Sabine Lautenschläger: Central bankers, supervisors and climate-related risks

Panel remarks by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank, at the NGFS (Network for Greening the Financial System) conference, Paris, 17 April 2019.

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The financial community's most important action with regard to climate change has happened in the last few years: many stakeholders in the financial industry, and central bankers, too, have realised that climate change is not an issue for next century. It's an issue for now, and it's a topic not only for other sectors but also for the financial sector and for central bankers and supervisors.

The ECB is paying a lot more attention to climate risks, not least through its participation in the Network for Greening the Financial System (NGFS). We think about and work on climate change-related risk from four broad perspectives:

- There is the question of how we use our microprudential supervisory arm to assess and address climate change-related risk in banks.
- There is the question of climate change-related risk and its impact on financial stability.
- There is the question of whether and how we take climate change into account in our investments in own funds and pension funds.
- And there is the question of how we assess the potential impact of climate change on the factors that are important to monetary policy.

We continue to conduct further research from all these perspectives. For example, we are collecting more information on the topic of climate change risk and green finance in order to have a better view of how exposed euro area financial institutions are to climate-related risks.

Collecting data and evidence is not an easy task, as we all know. There are no common definitions or taxonomies and we lack the overall data we need to assess the risk in the financial sector correctly. As the challenges posed by climate change are largely unprecedented, we need to dedicate considerable resources to understanding them.

In the area of banking supervision, this year the ECB has formally identified climate-related risk as one of the key risks facing the banking sector.

Here, we will assess how the banking industry looks at climate change-related risks from a risk management perspective.

And on this front, too, further knowledge is key. ECB Banking Supervision is collecting evidence on whether and how banks are dealing with climate-related risks. We would like to learn more about the constraints banks face when they assess environmental risks, and when they try to make their portfolios "greener".

So, we recently ran a pilot stocktake on a sample of banks to gather evidence on how they are approaching these challenges. We designed a qualitative questionnaire to evaluate how banks integrate climate risks into their strategy and their risk management framework.

Preliminary results show that, while many banks are already aware of the risks posed by climate change, much more needs to be done in this field. Banks seem to have approached this topic from a corporate social responsibility perspective rather than from a risk management perspective.

Some banks have asked for clear guidance from regulators, or for more information about best practices. Others see business opportunities. For example, some are interested in financing clean energy or issuing green bonds.

However, as I said before, the lack of common definitions and data makes it difficult to estimate the microprudential impact of these risks. It's clear, then, that the NGFS and other fora for cooperation and knowledge-sharing will continue to play a key role.

Last but not least, the ECB has worked to foster sustainable investment in our own non-monetary policy portfolios. For example, for the ECB pension fund, we have delegated proxy voting for equity investment to investment managers that have signed up to the United Nations Principles for Responsible Investment. With the help of our external asset managers, we are also looking to broaden the options for ECB staff to invest in sustainable financial products.

In the near future, we should first of all clearly define the policy parameters of green finance and climate change risks for us as central bankers and supervisors. The challenges we face with regard to climate change can only be successfully solved if all stakeholders accept responsibility. Central bankers and supervisors cannot replace the full range of political actions required to respond to climate change.

For example, I would caution that any potential changes to regulatory or prudential frameworks must be justified from a prudential perspective. We should do our utmost to acknowledge, assess and act upon climate change-related risks within our mandate, but we should not be obliged, for example, to promote green finance by granting banks preferential capital treatment if this is not justified by the specific risks linked to green finance.

Second, we need to organise and coordinate the work of the different global groups in order not to overburden the financial industry with a myriad of different information-collecting exercises. The NGFS could play a key role in this kind of coordination.

Third, we need to tackle – preferably on a global level – the lack of common definitions and taxonomies, as well as data and metrics. Without doing this, it is difficult to gauge the micro- and macroprudential impact of climate risks. We need to know more about the different risks of green and brown assets.

Therefore, I wholeheartedly support the request of the NGFS to establish a taxonomy of economic activities, including for green, non-green, brown and non-brown assets. We must fill the data and information gap we face as quickly as possible.

Fourth, from my perspective we cannot afford to wait until we have a perfect understanding of all these risks to take action. Climate change will not adapt to our research schedules.

So I am in favour of establishing, at least at the European level – and preferably even at the global level – a common set of supervisory expectations about how banks should deal with climate change and environmental risks. We could start with a modular approach, first addressing the governance issues before going into the technical topics.

Fifth, banks need to make progress in methods and practices for assessing climate change-related risks. Yes, it is about governance in banks – whether these types of risk are fully embedded in the risk management framework. But it is about risk assessment techniques, too.

So we should foster a stronger risk management perspective and techniques with regard to climate-related risks; it is about having an adequate mapping and classification of "at-risk" assets and including them in banks' forward-looking risk strategies with a longer time horizon than banks commonly use for assessing "traditional" risks. We all know how difficult it is to set key assumptions and different plausible scenarios for assessing the potential impact of these risks.

From a system-wide financial stability perspective, we will continue to monitor the transmission channels of climate-related risks. And thorough research, as well as intense discussions about scenario designs, will give us an idea of the range of possible impacts of climate change on the financial industry.

The ECB has begun work to compute the impact of climate-related changes on banks' capital positions, on other financial intermediaries and, ultimately, on the supply of funds to the economy.

One study, in particular, considers the channels through which climate-related risks are propagated to the economy as a whole. It finds that these risks will affect the earnings of the corporate sector, and this will have an impact on their probabilities of default, value of debt and equity. These changes will then be mapped onto banks' capital positions, or corporate bond and equity portfolios held by other intermediaries, to determine the overall impact on the supply of funds to the economy. This is very ambitious but important work.

Directly linked to this topic is the question of how climate change-related risk will affect the underlying factors that guide our monetary policy. Here, research is needed to get an idea of how the transmission channels can be influenced by climate change.

So there's more than enough work to be done, and this work is urgently needed and complex. We shouldn't delay.