


Laying the Foundations for a Net Zero Financial System - speech by Andrew Bailey

 Remarks at COP26



BANK OF ENGLAND

Andrew Bailey sets out the work the Bank of England is doing on climate change.

This includes:

- ensuring firms identify and address climate related financial risks
- considering climate change when we make decisions on the economy
- using the power of disclosure to incentivise change

Speech

It is a great pleasure to be at COP. What struck me was the range of the agenda over the COP fortnight and how diverse this essential agenda now is – from finance to gender and innovation to youth empowerment.

This is of course not surprising, as we know that climate change is an issue that will touch each and every one of us, the way that societies operate and the way that we live our lives, particularly as we emerge from COVID.

And a microcosm of this can be seen in central banks. When we started talking about climate at the Bank of England in 2015, our work was wholly focussed on the risks to the banks and insurers that we regulate. Six years later, the agenda has touched all areas of our organisation – from the way we heat our buildings, to the way that we manage our holdings of corporate bonds for monetary policy purposes. It is included in all of our remits and embedded in all of our decision-making processes. The Bank's staff are actively involved as part of their day job or in the contribution they make to the way of life at the Bank, next week is our internal 'green week'.

This is a mark of progress. The more we consider climate across our BAU activities and take informed actions on the back of those considerations – the better equipped we will be to facilitate a smooth transition.

That said, I have no doubt that this ever accelerating agenda can be hard to follow. So, today, let me try and piece together the different threads of the Bank's work, drawing out some key areas where I believe we have reached a series of pivot points as to the scale of our ambitions in the future. And let me then set out where I think the next frontier of work will be and where we will usefully invest our efforts over the coming period.

The first pivot point is microprudential. Since we started our work on climate in 2015, we and the financial sector have come a long way. In particular, since the PRA set its climate-related supervisory expectations^[1] in 2019, we have seen a step change among senior executives and boards at firms. Some firms are exhibiting genuine ambition in how they embed climate-related financial risks, demonstrating what can be achieved and highlighting where other firms could, and should, do more. And we have been enabling firms on their journey, through the Climate Financial Risk Forum, a group of industry representatives chaired jointly by us and the FCA which has just published its second set of practical guides,^[2] and with a particular emphasis on aiding smaller firms which may not have easy access to the expertise needed for this new agenda. And of course we have shared all our learnings with international colleagues, whether on disclosure in the G7 or on supervisory expectations in the Basel Committee (BCBS) and the Network for Greening the Financial System (NGFS).^[3] But there is much further to go.

That is why, as we enter 2022, we will be shifting gears in our supervisory approach domestically to ensure firms are identifying and addressing climate related financial risks. Rather than focusing solely on enabling, we will through active supervision be focusing also on ensuring our supervisory expectations on climate are met.^[4] Where progress is

insufficient and assurance or remediation is needed, the PRA will request clear plans and, where appropriate, consider exercise of its powers and use of its wider supervisory toolkit.

A key part of this toolkit is regulatory capital requirements, which help to ensure that firms have sufficient resources to absorb future financial losses. This supports their safety and soundness and contributes to the stability of the financial system as a whole. We already expect firms to hold capital against material climate-related financial risks and our existing toolkit enables us to take action. But we recognise capital may have a bigger role to play. Last week we published a report^[5] that sets out our thinking on capital and what further work is needed over 2022 to determine if further changes to the regulatory capital framework are necessary. Let me be clear. Regulatory capital can and should provide resilience against the consequences of climate change, namely financial risks. But it is not the right tool to address its causes. Addressing the causes – driving the transition - is for climate policy and is rightly the responsibility of governments.

The second pivot point is scenario analysis. We have spent several years developing climate scenarios as part of our work within the NGFS.^[6] Scenario analysis is a key tool for understanding how firms and our economies are exposed to the risks from climate change under a range of potential future pathways. The Bank of England,^[7] alongside more than twenty other NGFS members,^[8] is using these NGFS scenarios to run exercises, and as results come in over 2022 we will be able to assess the risks to the financial system. These scenarios are not just for use by regulators and governments, the NGFS deliberately made them openly available for use by firms whether in finance or in the real economy and other organisations in their own scenario analysis. The NGFS has also been open in how the scenarios have been constructed so that experts can challenge and suggest improvements.

We are now also starting to utilise the scenarios for a range of other topics, such as the impacts on the macroeconomy, both from the physical impacts of climate change as well as the different transition pathways to meet net zero commitments. The MPC has had its first discussion on climate change. Under the UK's G7 Presidency this year, we have been able to catalyse action to prioritise furthering our understanding of the macroeconomic impacts of climate under different transition paths, with the G7 committing in June to embed climate change considerations into economic and financial decision-making, including addressing the macroeconomic impacts.^[9] And we will continue to work with other central banks, finance ministries, and international organisations to make progress on this important topic, including through the NGFS and the Finance Tracks of the G7^[10] and G20.^[11]

This brings me to the third pivot point. For the past two years, we have issued broad TCFD-based climate disclosures. These disclosures set out our climate change strategy and demonstrate how companies can and should share information about the measurement and management of climate-related risks. Over the coming days, we will be launching a new approach to investments by the Corporate Bond Purchase Scheme (CBPS), drawing on feedback on a discussion paper we published in May. Our approach will use our role as an investor for monetary policy purposes to incentivise firms to take meaningful actions in support of climate transition. It will therefore take an important step for central banks in focussing on the impact of the financial system on climate change, as well as vice versa. We are also implementing changes to achieve our 2030 milestone towards meeting our net zero emissions target for 2050 across all our operations.

That brings me nicely to international cooperation. For many topics we say global issues need global solutions. That may be even more true here than for other topics. No country, company or person can tackle climate change alone. We must continue to work together, after all that is why the 26th Conference of Parties is happening and why we are here. We play a very active role within the NGFS, where today the 90+ members, including the Bank, pledged their action. We chair the Sustainable Insurance Forum, contribute our thinking in the international standard setters and we will hear from some of these organisation in a few minutes. We will continue to play our role, a leading role.

In six years we have learnt a lot, achieved a lot, but as with everything on climate change, there is an awful lot more to do. We will look forward, challenge ourselves to go further, and deliver tangible action. Let me conclude by highlighting three points here. First, in terms of its economic effects, we are already beginning to see the impact of climate change. An example of this is energy prices – we must be able to manage the resilience and thus economic effects of the transition as we reduce the use of hydrocarbons but still rely on them. Second, we must ensure that the

supply chains which will support the renewable economies of the future are robust, otherwise we will compromise the change we must achieve. Third, we must use the power of disclosure for companies to incentivise change over an acceptable timeframe. I know that last message is not always popular – it doesn't have the message of stopping investment, but rather incentivising it to change in its impact - but it is realistic and will lead us to the goal that we must achieve. Thank you.

I am grateful to Theresa Löber and David Gayle for their help in preparing these remarks.

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1. [Supervisory Statement SS3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change](#)
 2. See: [the Climate Financial Risk Forum page](#)
 3. [Network for Greening the Financial System](#)
 4. The [PRA's Climate Adaptation Report](#) sets out our supervisory strategy in response to climate change from 2022.
 5. [PRA Climate Change Adaptation Report 2021 - Climate-related financial risk management and the role of capital requirements](#).
 6. See: [Network for Greening the Financial System Scenarios Portal](#)
 7. I.e., via the Bank of England's [Climate Biennial Exploratory Scenario](#) (CBES).
 8. [Scenarios in Action: A progress report on global supervisory and central bank climate scenario exercises](#)
 9. See: [G7 FINANCE MINISTERS & CENTRAL BANK GOVERNORS COMMUNIQUÉ](#)
 10. See: [News story - G7 Finance Ministers agree to work together to address global supply chain pressures](#)
 11. See: [Fourth G20 Finance Ministers and Central Bank Governors meeting](#)



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