Denis Beau: Sustainability challenges in the missions and operations of the Banque de France

Introductory speech by Mr Denis Beau, First Deputy Governor of the Bank of France, at the Climate and Territory Conference, Reims, 26 September 2024.

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Presentation accompanying the speech

Introduction

A very good morning to you all,

I am delighted to be taking part in this **conference on the fight against climate change, the economic and financial challenges it presents and the actions we can take to address this. I wish to thank the RECOM circle**, which brings together institutions in the department of the Marne that are committed to economic development, and the NEOMA Business School, for inviting me to take part in this conference. Thank you also for giving me the opportunity to introduce the exchanges between the experts that you have invited and to present the objectives and actions that the Banque de France is developing in this area.

[Slide 2] The Bank's commitment to fighting climate change, and more broadly to the challenges of sustainability, has been embodied for many years both in its internal management methods and its responsible investment activities, launched in 2018, as well as in the exercise of all the major missions entrusted to it by the legislator. We have just published a report that consolidates all of our commitments and actions for the first time, leading to recognition of the Banque de France as the first G20 central bank to incorporate climate risks into its activities.

[Slide 3] In light of the debate over central banks' role in contributing to public policies that combat climate change and its effects, my presentation will focus on measures which we have adopted at the Banque de France. Our role consists in incorporating our contribution to fighting climate change into the way in which we exercise and comply with the mandates entrusted to us by the legislator in the areas of monetary policy, financial stability and services provided to economic stakeholders. The main aspects of this incorporation, which I will outline later, reflect our desire to avoid two potential pitfalls: doing too much – by interfering in public policies, which are a matter of government decisions, and which must incorporate appropriate incentives in the form of regulations, carbon pricing and subsidies – and not doing enough.

1. Conducting monetary policy

We incorporate climate risk into our monetary policy activities based on the observation that climate change has macroeconomic implications for growth and inflation that need to be taken into account. [Slide 4],

Climate change is already affecting prices and economic activity: for example, severe droughts have cost Argentina 3% of its GDP,[1] floods in Pakistan have caused damage and losses equivalent to 8% of GDP,[2] not to mention the recent rise in global food prices.

Moreover, a variety of climate shocks are likely to materialise in the future, with potentially massive consequences for growth and inflation.

This quadrant [slide 5] **presents four categories of potential climate-related shocks attributable to physical risks** (i.e. climate disasters) or **transition risks** (i.e. disorderly transformation of our economies):

- Negative supply shocks, such as a disorderly introduction of a carbon tax (transition risk) or frequent and severe natural disasters (physical risks).
- Negative demand shocks, such as a crisis of confidence linked to regulatory uncertainty (transition risk).
- Positive demand shocks, such as increased public spending and investment.
- Positive supply shocks, such as a productivity boost from green innovations.

These shocks may occur together or consecutively. Their individual probabilities are difficult to assess at this stage, although the negative supply shock (top left) would appear slightly more likely than the others. This uncertainty is due in particular to the political decisions to be taken by each State. For example, changes in carbon pricing, volumes of 'green' investment and public subsidies will all impact the climate change trajectory and its economic consequences.

Given this broad range of possible shocks, incorporating climate risks into the conduct of monetary policy means incorporating them into our macroeconomic assessment and forecasting models and using climate scenario analyses. And this is what we are doing as part of the ECB's climate agenda[3] finalised in July 2022, by working specifically to take better account of the risks to price stability in the macroeconomic forecasting models we use. We are also working on short- and long-term scenarios under the aegis of the **Network for Greening the Financial System (NGFS), a network of nearly 140 central banks and supervisors, co-founded in 2017 by the Banque de France** (which provides the Secretariat of the Network) and other partner institutions. The NGFS carries out research, and defines and promotes best practices for mainstreaming climate risk into the activities of central banks and supervisors.

Seven long-term scenarios, with a 50-year time horizon, have been developed by the NGFS [slide 6] in line with the approach taken by the IPCC. Some of these scenarios assume that ambitious climate policies will be introduced quickly and will gradually become more restrictive. Others assume that these policies will be introduced too late or in a piecemeal and uncoordinated manner between different countries. This translates into different climate change impacts: a rise in global temperatures of 1.1°C by 2100 under the most optimistic scenario, and by 2.8°C under a more pessimistic one. [*left-hand chart*] According to NGFS estimates, this would have a negative impact on global GDP of 4% to 6% by 2030, and a negative impact of almost 14% by 2050.[4] [*Middle chart*] Obviously, certain regions would be more affected than others. Regarding inflation, under the 'Net Zero in 2050' scenario, it would rise by almost 1.5 percentage

points per year in Europe within two years, and by almost 4.5 percentage points per year in China. This scenario indicates a sharp short-term rise in inflation. The 'Delayed Transition' scenario predicts that inflation will start trending upward around 2030 [*right-hand chart*]. These scenarios will be updated by the NGFS between now and the end of the year; the new version is expected to present even more severe economic medium- and long-term climate change impacts.

This work on scenarios and models to incorporate the impacts of climate risks into the definition of a monetary policy stance that ensures price stability also goes hand in hand with efforts to adapt our operational framework for implementation purposes. Consequently, working with the ECB, we are already in the process of greening our corporate bond purchase programme and adapting our collateral arrangements.

We have taken these decisions not only because they reduce the exposure of our balance sheet to climate risk, and are therefore justified in the context of prudent management of the risks to which we ourselves are exposed, but also because they can influence the behaviour of our counterparties and act as a catalyst in the transition process to a green economy.[5] This will thereby enable us to contribute to protecting the environment, which is one of the secondary objectives of monetary policy set out in the European treaties.

2. Financial stability and financial system supervision

The Banque de France and the *Autorité de contrôle prudentiel et de résolution* (ACPR - Prudential Supervision and Resolution Authority) have also been working to integrate sustainability issues – particularly climate, environmental and social issues – into their financial stability mission.

[slide 8] In its role as supervisor, the ACPR began a sustained dialogue with the financial community in 2015 in the wake of COP 21, focusing on how climate-related risks should be taken into account by the financial sector. This dialogue together with the analytical work performed by the ACPR, particularly within the framework of the French law on Energy Transition for Green Growth (LTECV), culminated in **good practices for climate-related and environmental risk management** for banks. This pioneering guide, published by the ACPR in 2020, is a **reference for the thematic reviews** that we have been conducting since last year with banking institutions not directly supervised by the ECB. It was adapted for insurance undertakings in 2022.

At the same time, a **climate stress testing pilot exercise was conducted in the banking and insurance sectors in 2020.** We called it a 'pilot' exercise because, once again, we were a pioneer among the main central banks and **we showed the way by developing methodologies and raising awareness among banks and insurers of the need to strengthen their capacity to measure and anticipate the consequences of climate change**. The ACPR repeated this exercise in July 2023 for the insurance sector only and published its findings last May.

These stress tests are important because they allow to assess the robustness of banks and insurers, and therefore their **ability to finance and insure localities and regions**

under adverse climate risk scenarios involving either extreme events or the implementation of policies to transition to a low-carbon economy.

[slide 9] Driven by this conviction, the Banque de France and the ACPR made a major contribution to developing and conducting the **first Europe-wide climate stress testing exercise in 2022**, by making their findings available to the ECB. They also played a major role in **developing the scenario deployed by the three European supervisory authorities (EBA, EIOPA and ESMA) for conducting a stress test this year dedicated to assessing the transition risks associated with the 'fit for 55' legislative package**, which aims to reduce EU greenhouse gas emissions by 55% between 1990 and 2030.

As well as carrying out stress tests at European level, **the ECB was also able to draw on the work of the ACPR to develop its prudential expectations in terms of governance and management of climate-related risks**. These expectations are closely monitored by the ECB, particularly through the Supervisory Review and Evaluation Process (SREP), **and must be fully met by the banks it supervises by the end of 2024 if they wish to avoid being subject to sanctions.**

The role of supervisors in monitoring and assessing efforts to incorporate climate risk into the management of financial institutions will be strengthened by the **revised Capital Requirements Directive (CRD)** and the **requirement for banks to develop prudential transition plans.** The exact content of these plans is currently being defined by the EBA and EIOPA. They will have to reflect both transition and physical risks, and their robustness will be assessed by the supervisor.

Finally, the **Banque de France and the ACPR continue to participate in both European and international efforts**, particularly to take greater account of climate-related risks in prudential regulations, still using a risk-based approach, and more generally to improve knowledge and understanding of nature-related risks.

3. Services to the economy and support for businesses

In 2019, the NGFS clearly stated that climate risks are above all a societal and human risk, but also a financial risk. "As central bankers and supervisors, we therefore have a *duty* to concern ourselves with climate change in order to perform our monetary and financial stability mandates" (F. Villeroy de Galhau). **The increasing risks associated with climate change are creating major challenges even for businesses.** As such, to round out France's ecological planning strategy, the Ecological Transition Financing Committee (CFTE) has tasked the Banque de France with "**devising a national climate indicator for businesses**".

The aim of the climate indicator project is to provide companies with a free assessment of their transition, their exposure to climate hazards and the extent to which they are incorporating climate issues.[6]

[Slide 11] The climate indicator, **which aims to cover all aspects of climate risk**, is broken down into three dimensions:

- **Transition** (ICT), drawing on ADEME's Accelerate climate transition methodology (ACT), measures alignment with a low-carbon world.[7] It compares the business's greenhouse gas emissions trajectory, projected on the basis of tangible actions in its transition plan, with its baseline trajectory, built around its activity volumes and sector baselines.[8]
- **Physical risks** (ICP) predict future trends in various climate hazards (heatwaves, precipitation, hail, fire, drought, snow/frost) projected under the IPCC's SSP2-4.5 scenario, in the geographical areas to which the business is exposed.
- **Maturity** (ICM) reflects a more qualitative assessment of the company and measures its degree of awareness of climate issues and its preparedness, or even implementation, of decarbonisation and adaptation measures.

[Slide 12] Following an initial testing phase, the climate indicator will be rolled out **progressively**, with priority given to **sectors facing major decarbonisation challenges. "It will be deployed in liaison with all the players and sector-based initiatives, with the aim of not overburdening our businesses and SMEs"** (F. Villeroy de Galhau).

To devise a reliable and useful assessment for companies and in order to avoid any 'greenwashing', it is necessary to collect certain data from businesses, including information on **tangible decarbonisation initiatives** either undertaken or planned.

Naturally, to avoid overburdening companies, the Banque de France will capitalise on existing reporting, especially CSRD data and EFRAG standards.

To perform this mission, the Banque de France relies on its local branches, which are present in each *département*, together with its existing relations with hundreds of thousands of companies forged through its traditional business of providing company ratings. Data collection will be facilitated by "Manager Portals", the Banque de France's new online channel for communicating with businesses.

The amendment to the French Green Industry Act in respect of the climate indicator provides for the creation of a **monitoring committee by the French Ministry for the Economy and Finance**, bringing together all players with an interest in the climate indicator (i.e. public institutions, businesses, financiers, qualified individuals) and tasked specifically with assessing the climate indicator methodology, its consistency with European standards and the reporting workload for companies.

To ensure that our methodology is transparent, the Banque de France regularly meets with businesses, professional federations, financial players and public authorities and keeps them informed of developments. **Between now and 2027, the Banque de France climate indicator should become the most accurate tool** for assessing the transition achieved by companies, their exposure to climate hazards and the degree to which they have incorporated climate issues. For France, this approach is an essential component in the success of the Paris Agreements.

Conclusion

I hope I have clearly explained both the foundations and the reality of the Central Bank's pro-climate actions and convinced you that we are striving to make a full and fair contribution in line with the mandates with which we have been entrusted. But central banks cannot be the only players involved in greening our economies. As the Governor of the Banque de France recently stressed: "[-] we are faced with huge investment needs for the ecological transition [-] But monetary financing cannot fund the transition; and central banks – and green finance – cannot be the only green game in town; they cannot replace sound public policies and corporate transition plans."

So, we all need to play our part and combine our efforts in the fight against climate change. Now, without further ado, I'm going to hand over to Julien Bouillé from the Union, to lead the debates and have my fellow experts express their opinion concerning the many issues raised by climate change and the actions that have been or need to be taken.

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[1] Bolsa de Comercio de Rosario, The cost of the 2022/23 drought already amounts to more than USD 14.14 billion for soybean, wheat and corn producers, 10 March 2023

[2] World Bank, Flood damages and economic losses over USD 30 billion and reconstruction needs over USD 16 billion, October 2022

[3] ECB climate agenda, 4 July 2022

[4] NGFS, NGFS Scenarios for central banks and supervisors, November 2023

[5] ECB climate agenda, 2022

[6] By 2027, 20,000 businesses will be targeted across 14 sectors, accounting for 60% of France's greenhouse gas emissions.

[7] The trajectory must be compatible with keeping global warming to 1.5°C by 2100, in line with the IPCC's SSP1-1.9 scenario.

[8] Provided mainly by the International Energy Agency (IEA)