Climate Bonds Initiative

Media Release

Expanded Role for Central Banks to Green Global Financial System

Report outlines measures to address systemic climate risks & aid shift in capital allocation

Washington D.C./London 16/10/19: 08:00 EST 13:00 BST: Developing a brown taxonomy, shifting purchasing towards green assets and reviewing the doctrine of market neutrality are amongst the measures central banks and financial regulators (CBFR) should apply to address the systemic risk climate impacts pose to the global financial system, a new report recommends.

Produced by Climate Bonds Initiative in conjunction with the SOAS Centre for Sustainable Finance and WWF, *Greening the Financial System: Tilting the playing field - The role of central banks* is being released in the lead up to this year's World Bank/IMF annual meetings in Washington D.C.

Greening the Financial System analyses global progress by central banks in addressing climate issues. The report advocates accelerated action by central banks and micro prudential regulators including greater use of prudential and regulatory powers, central bank asset purchases and credit guidance policy to:

- reduce systemic financial sector vulnerability to climate risks
- increase global green capital allocations and
- support transition amongst banks, insurers and other financial institutions.

Recommendations:

- Central banks should develop a brown taxonomy. Central banks are uniquely concerned with the systemic risks to the financial system arising from financial institutions' ownership of brown assets which are increasingly vulnerable to sharp revaluations and pricing volatility from climate mitigation policy and physical risks.

- Central banks are major purchases of financial assets. The Eurozone central banks bought EUR2.6tn of assets (10% of Eurozone countries' GDP) through the Asset Purchasing Programmes which are still replenishing holdings. *Greening the Financial System* recommends purchases be deliberately skewed to buying green assets, including assets on the primary market and recommends the doctrine of market neutrality be removed.

- Central banks, through setting haircuts and weightings of different assets, greatly influence the assets held by banks and insurance companies for prudential regulation. *Greening the Financial System* recommends that the brown taxonomy be used to discourage use of brown assets as these are increasingly vulnerable to climate risks not yet captured by current climate models.

- Central banks are understandably opposed to making the prudential regulations less stringent. Accordingly, they should test whether green supporting factors could be applied to offset some of the impact of using the brown penalising factors. Such a policy would encourage investment in green technologies through increasing the demand for the assets for regulatory purposes.

Ulrich Volz, Founding Director of the SOAS Centre for Sustainable Finance, SOAS University of London:

"Central banks and financial supervisors have a key role to play in ensuring that the financial sector addresses climate and other environmental risks and that financial flows are aligned with the Paris Agreement. Financial governance can be only part of a broader public policy response to addressing the climate crisis, however its role cannot be overstated. This report provides an excellent overview of the current state of discussion and makes proposals that merit further scrutiny. While I don't agree with all of the report's recommendations, they will contribute to a much-needed discussion that will help central banks and supervisors develop adequate policies in response to the climate crisis."

Sebastien Godinot, Head Sustainable finance, WWF European Policy Office:

“Central banks and regulators have important powers to ensure that environmental risks are assessed, disclosed and mitigated by financial institutions. This new report is an excellent review of the actions central banks and supervisors should take forward: we hope that climate scenario testing will rapidly become a new normal and, with more environmental risk disclosure, will accelerate the discussion about how to adjust risk weightings, collateral frameworks and monetary policies with sustainability factors."

Prashant Vaze, Head of Policy and Government, Climate Bonds Initiative:

“There is increasing recognition by central banks of the growing structural and systemic risks that climate change poses to the financial system and the need for coordinated action. The establishment of the NGFS has been a major step forward in that process. Developing and expanding response mechanisms using central banks prudential regulation & monetary policy toolkit to offset climate risk and support orderly transition is the next stage.”

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Acknowledgements: *Greening the Financial System - Tilting the playing field - The role of central banks* has been produced by the Climate Bonds Initiative in conjunction with SOAS Centre for Sustainable Finance and WWF.

Report download.

Major Recommendations

Policy measures to stimulate green investment	**When?**
Market Infrastructure	
1. Define a brown taxonomy and guide on its usage	Short-term
Decision useful transparency	
2. Mandate FIs to disclose climate risks	Immediately
3. Climate scenarios and stress tests	Short and medium-term
Prudential	
4. Adjust risk weightings for capital adequacy on brown assets	Medium-term
5. Adjust High Quality Liquid Assets haircuts	Medium-term
Monetary	
6. Brown penalties support factors for collateral framework	Medium-term
7. Offsetting green support factors for collateral framework	Medium-term
8. Align APP with ESG objectives	Medium-term
Other functions	
9. Green reserve management & pension funds	Short-term
10. Central banks that already use credit guidance tools should extend them to include green lending	Short-term

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About the Climate Bonds Initiative: The Climate Bonds Initiative is an investor-focused not-for-profit, promoting large-scale investment in the low-carbon economy. Climate Bonds carries out market analysis, policy research, market development; advises governments and regulators; and administers a global green bond Standards and Certification Scheme. Please visit http://www.climatebonds.net.
