

Time for central banks to face climate change

Seventy percent of central banks and regulators see climate change as 'major threat' to financial stability, but are split on where responsibility for action lies.



Image source: Getty/Gallo

'Four years after the Paris agreement the climate change debate continues to proliferate. Climate change will impact all financial institutions and the topic is high on the agenda of supervisors and regulators around the globe,' says Rudi Lang, partner, leader financial institutions group at Mazars.

The audit firm, and OMFIF, the independent think tank for central banking, economic policy and public investment have launched the [\https://www.omfif.org/tacklingclimatechange/ *Tackling climate change: The role of banking regulation and supervision*. report on how central banks and regulators are responding to the climate crisis.

A threat to stability

The report, based on research and surveys with 33 central banks and regulatory authorities, finds that 70% of respondents consider climate change a 'major threat' to financial stability.

Recognition – but what reaction?

Just over half of central banks (55%) say they are monitoring climate risks. But there is disagreement over responsibilities, with 12% overall saying that, while they see climate change as a major risk, action should come from other policy institutions, such as government departments.

Regulatory approaches to climate risks

Central banks and regulatory authorities are increasingly integrating climate risks into their activities. Moving ahead, top measures expected are:

1. Assessing climate risk as a financial risk in stress tests
2. Encouraging or mandating climate-related financial disclosures
3. Setting sustainability criteria standards for green finance/lending by regulated banks

While 'market-fixing' initiatives – which involve correcting market failures in financial markets – are gaining traction, central banks report being wary of using more interventionist 'market-shaping' prudential and monetary tools for climate purposes.

Obstacles

Almost all respondents highlighted the lack of appropriate analytical tools, methodologies and data as major problems. Data availability and quality are the key concern for 84% of respondents.

Fragmentation of climate-risk frameworks is also deemed a key challenge, with 31% of respondents concerned about the comparability and consistency of supervisory frameworks.

More climate stress-testing expected

The inclusion of climate-related considerations in stress tests is still at an early stage with only a minority (15%) of respondents currently including them in their routine stress tests of financial institutions. But this is set to soar, as nearly four-fifths (79%) say they intend to do so in the future.

Facing the future

"The success of any policy response will rely on the engagement of market participants who will be expected to assess, disclose and mitigate their climate change risk and continue to change some of their practices,' says Leila Kamdem-Fotso, partner, financial services, Mazars, and contributor to the report. "Encouragingly, collaboration has already started between regulators and the private sector through various initiatives."

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