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Market Risk Advisory Committee Statement
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Commissioner Benham, members of the Committee, thank you for the opportunity to speak to you today about the Bank of England's work on the financial risks from climate change.

The Bank of England has been clear for some time that climate change creates financial risks that matter for the safety and soundness of the firms we supervise and for financial stability more broadly[1].

These financial risks manifest as physical risks and transitional risks.

Physical risks arise from damage to property, land and infrastructure from climate and weather-related events such as heatwaves, droughts, floods and rises in sea level. These events can cause financial losses, increased insurance claims and impairments to asset values and borrower creditworthiness.

These are not just risks for the future. By way of example, inflation-adjusted insurance losses from such events have increased by a factor of five in recent decades[2].

Transition risks arise in the adjustment to a lower carbon economy. Changes in climate policy, technology and market sentiment can prompt a reassessment of asset values as changing costs (and opportunities) become apparent. The need to transition is widespread – affecting energy, transportation, infrastructure, agriculture and real estate to name just a few.

The timing and form of transition is inherently uncertain. But here too risks are already materialising - for example, through tightening energy efficiency standards impacting on property markets or credit risks associated with the low-carbon transition emerging in the automotive and energy sectors[3].

In addition liability risks can arise as a consequence of either of these risks – as those who have suffered losses seek compensation from those they hold responsible as a result of their action or inaction on climate change.

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[1] https://www.bankofengland.co.uk/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability

[2] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/impact-of-climate-change-on-the-uk-insurance-sector.pdf

[3] https://www.bankofengland.co.uk/news/2018/september/transition-in-thinking-the-impact-of-climate-change-on-the-uk-banking-sector

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In our view the financial risks that climate change creates are distinctive. They are far-reaching in breadth and scope; they are foreseeable; and their future size will be determined by the actions taken today. Raising awareness and understanding of these risks is in our view necessary.

Sizing these risks is highly complex. We need to translate a myriad of possible climate pathways - with different physical and transition effects - into economic outcomes and financial risks looking ahead over many decades.

Many of the modelled estimates we currently have are not very good. Models are partial, heavily dependent on assumptions, and do not capture well the non-linearities that are a key feature of the most recent climate analysis. Data gaps are significant.

We are therefore working together with industry and other regulatory authorities to build intellectual capacity, develop new toolkits, and identify best practice.

In our work with the financial system, we are taking a two-pronged approach, tackling the issue top-down and bottom-up.

The action of individual institutions will be critical in determining whether climate-related risks are well managed. To that end, we have issued supervisory expectations covering governance, risk management, scenario analysis, and disclosure that set out how the banks and insurance companies we regulate need to develop an enhanced approach to managing the financial risks from climate change[4].

To support development of best practice, we have established the UK Climate Financial Risk Forum, co-chaired by the Prudential Regulation Authority and the Financial Conduct Authority, which brings together a wide range of industry participants (banks, insurers, and asset managers)[5]. We have established four workstreams – disclosure, risk management, scenario analysis and innovation – with an aim to publish practical guidance.

The Bank is also a clear supporter of the disclosure of financial risks from climate change - by financial firms and more broadly - in line with standards set out by the Task-force on Climate-related Financial Disclosures[6].

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[4] https://www.bankofengland.co.uk/prudential-regulation/publication/2019/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change-ss

[5] https://www.bankofengland.co.uk/news/2019/march/first-meeting-of-the-pra-and-fca-joint-climate-financial-risk-forum

[6] https://www.fsb-tcfd.org/

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Disclosure is critical if the financial system is to be able to weigh risks and investment accordingly.

It needs to be forward-looking, speaking to future risks and opportunities, not just the current position. That needs scenario analysis – data driven narratives that help anchor assessments of risk and enable us to focus not on what will happen but what might happen.

Scenario analysis can also help us consider this risk at the level of the system as a whole and so bridge the gap between our top-down and bottom-up understanding of risk.

To that end, the Financial Policy Committee and the Prudential Regulation Committee will consider including climate related factors in a future Biennial Exploratory Scenario. We are also asking UK insurers, as part of our market-wide insurance stress tests this year, to consider how their businesses would be affected in different physical and transition risk scenarios. And the central banks and supervisors Network for Greening the Financial System plans to set out voluntary guidelines for how central banks can use scenario analysis to assess system-wide financial risks from climate change[7].

This is an immature field. We have much to learn from working together.

[7] https://www.banque-france.fr/en/financial-stability/international-role/network-greening-financial-system/first-ngfs-progress-report