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Closing Address

2nd Green Finance Workshop on the inclusion of climate risks by rating agencies
/ Banco de España

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Good morning, and many thanks for attending this second workshop on green finance organised by the Banco de España.

As you may have noted, the Banco de España is genuinely interested in promoting debate on the challenges posed by climate change. In particular, we wish institutions to be aware of the repercussions of this change on their business model. We also intend to explore the avenues through which the financial system, which performs the function of channelling funds, may contribute to the transition towards a more sustainable economy, while attempting to avoid the more dramatic effects of such change.

You are probably aware that, as the Banco de España's Deputy Governor, I participate in the plenary meetings of the Network for Greening the Financial System (NGFS), a network of central banks and supervisors, comprised of 46 members and nine observers, which aims to strengthen the global response required to achieve the goals of the Paris 2015 agreement. The banking sector plays a key role in achieving such goals. To this end, it should analyse in depth and improve the management of environmental risks in its own portfolio, helping to mobilise capital for green and low-carbon investments.

At the NGFS we are working on three courses of action: (i) identifying macroeconomic and financial risks linked to climate, (ii) analysing the practices supervisors should follow to oversee the solvency of credit institutions in the face of these risks, and (iii) developing financial markets that make it possible to efficiently channel the funds needed to transform the economy into a sustainable model.

I believe we all agree on the need to achieve these three goals and that all those present (banks, supervisors and rating agencies) can contribute to this end. As you may imagine, I hold regular meetings with banks, so I will take this opportunity to briefly address the credit rating agencies attending this workshop. Specifically, I will attempt to explain how they can contribute in one of these three areas.

- First, identifying climate risks is evidently a considerable challenge, since we are facing an unprecedented situation (therefore, without data). Indeed, just by looking at default rates in the Spanish economy during the latest crisis, we would see that the sectors we could classify as "brown" produce the lowest rates. Actually, I think this is not surprising, since these are very mature sectors with broad margins. However, it is well known that transition risks are reflected in situations of abrupt change to the environment, to which certain firms do not know how to adapt or are unable to do so. Against this background, it is advisable not to lose sight of the fact that environmental transition plans have, indeed, been drawn up and announced. The European Commission aims to achieve a fully decarbonised economy by 2050 and, accordingly, there are projections about what might happen, although there is uncertainty over how it will happen. Clearly, analysing the potential changes in the environment which might affect corporate solvency is essential to assessing and managing risks in the financial system, regardless of whether the origin of such changes is technological, related to customer behaviour, regulatory or environmental; however, it is also undoubtedly an element to be analysed in external ratings.

- Second, as regards banking supervision, we must ensure that climate risks are properly included in banks' asset portfolios. This is a tremendous challenge, because we do not have all the information necessary to calculate these risks, at least in a sufficiently granular manner, at firm level. Of course, we must also be aware of the difficulty this type of analysis entails for the banking sector. Assessing the carbon footprint or climate risk of a very large loan to a major Spanish firm differs greatly from doing so for loans to SMEs, although there are several tools which may be useful. For instance, in the case of mortgages, public deeds include energy performance certificates. There are also initiatives based on new technologies for recognising invoices and supplies to calculate the carbon footprint of even the smallest SME. Finally, in order to assess the advisability of introducing a "Brown Penalising Factor" or a "Green Penalising Factor", we must understand how institutions include climate risks in cost and capital, or how credit ratings take them into account. Once again, credit rating agencies play a very important role in this debate.
- The third NGFS working group aims to analyse how financial markets can contribute through financing the achievement of a sustainable economy. In this connection, last month, during the International Monetary Fund's autumn meetings, we presented the manual for inclusion of sustainability and responsibility criteria in central bank portfolio management, in whose drafting we actively participated. Obviously, although the manual is mainly aimed at portfolio managers at central banks, useful lessons can be drawn for the industry as a whole. Evidently, the development of strategies for investing in green bonds requires a much more developed market than the current one, with greater consistency regarding which assets are green and which are not. This is something for which initiatives such as the Taxonomy currently being developed by the European Union are essential. For the time being, green bonds are only a global fixed-income market niche. If we wish financial markets to play a truly vigilant role in the face of climate change, sustainability and responsibility criteria need to be applicable to all bonds in circulation. Once again, developing efficient markets requires the correct assessment of climate risks, starting with rating agency assessments.

Naturally, in addition to the to-do list for institutions and rating agencies, supervisors also have a number of tasks pending. As an NGFS member, the Banco de España has undertaken to make progress in four areas, in response to the four key recommendations included in the first NGFS comprehensive report.

First, we must move towards integrating climate-related risks into the monitoring of financial stability and supervision. In this connection, the Banco de España is already working on implementing in the near future stress tests revolving around different ecological transition scenarios, encouraging institutions to develop risk models addressing climate change. Also, under the draft Climate Change and Transition bill the Bank is to prepare an annual report on the impact of the financial system on the environment.

The second recommendation in the NGFS report relates to the integration of sustainability factors into portfolio management. In this area, the Banco de España is incorporating environmental sustainability as a strategic reserve management goal. We have also recently participated in the creation of a new green bond investment fund launched by the Bank for International Settlements.

Third, the report recommends central banks bridge gaps of information and data that are relevant for climate risk assessment. Here, the Banco de España is already collaborating in the Eurosystem's working groups to develop consistent methodologies for assessing the level of sustainability of own portfolios, within a broad project that aims to make progress in integrating green principles into reserve management.

Finally, the fourth area in which the Banco de España is involved is responsive to the NGFS's fourth recommendation to build awareness and intellectual capacity regarding sustainable finance, encouraging technical assistance and knowledge-sharing. Actions in this field include both this workshop and that held last month, with Environmental, Social and Governance (ESG) data providers, as well as preparing specific publications on sustainable finance and holding thematic meetings with the industry. This workshop's audience proves that there is genuine concern on the part of the finance industry, comprising both issuers and investors, and a true need for risk measurement data, models and guidance. We at the Banco de España also seek to address this challenge, as shown by the activities I have mentioned, and as exemplified by this workshop.

I would not wish to conclude without mentioning the World Climate Summit to be held in Madrid next month. The main experts and world leaders will make presentations and the whole world's attention will be on us. I believe this occasion should serve as an opportunity to analyse what we are doing, whether we are on the right track and whether our actions are sufficient. I hope that the conference which the Banco de España will organise on 11 December, as part of the side events at the Summit, may serve as a framework to reflect and, in particular, to continue to make headway, on all these issues.

Let me conclude by underscoring once again the importance of the role credit rating agencies can and should play in the face of this fresh challenge. Their experience in modelling risks is undoubtedly particularly relevant in this setting and for this reason we hope we will be able to develop a fruitful collaboration.

I shall not take away any more of your time this Friday. I hope this session has been useful and I look forward to seeing you soon at another workshop.