Press release

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Banks and insurance have key role to play in reducing climate-related financial stability risks, joint ECB/ESRB report finds

- Banks significantly exposed to high-emitting firms and households, with future climate risks underpriced and underinsured
- Macroprudential policy can keep systemic risk in check with existing instruments and complement microprudential efforts
- Strong economic dependence on natural ecosystems could exacerbate climate-related financial stability risks

The European Central Bank (ECB) and the European Systemic Risk Board (ESRB) today published a joint report on the impact of climate change on the European Union (EU) financial system. The report sets out detailed frameworks for addressing risk to the financial system by (i) gathering evidence on the most important financial stability indicators via a surveillance framework and accompanying Chartbook, (ii) leveraging this evidence to develop a macroprudential strategy for addressing climate risk, and (iii) extending the scope from climate-related risks to broader nature-related risks.

Banks have a key role to play within the financial system when it comes to managing and reducing risks to financial stability that arise from emissions of the EU economy, the report finds. This is because banks lend disproportionately to sectors with high exposure to climate-related risk. The share of high-emitting sectors in bank lending is around 75% higher than its equivalent share in economic activity, meaning that these sectors are over-represented in banks' loans. Similarly, 60-80% of all mortgage lending in the euro area is to high-emitting households.

Climate change is an increasingly salient topic, not only because of an already visible increase in the frequency and severity of climate hazards, but also because plans for a European green transition are

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becoming more concrete. Reassessing and repricing climate risk could create financial instability through numerous channels with high exposure to climate-related risk. This includes the transmission of climate shocks through global value chains and the potential for financial contagion as both banks and financial markets seek to simultaneously reposition their asset portfolios against the backdrop of a significant insurance protection gap.

The report makes the case for a robust macroprudential strategy to tackle these risks. A system-wide prudential approach would focus on managing risks not only for the banking sector but also for borrowers. Moreover, it would tackle risks in non-bank financial intermediation, notably gaps in insurance protection and information, including the need for reliable disclosures and robust green labels. It would also complement ongoing microprudential efforts, including ECB Banking Supervision's work on climate-related and environmental risk. This approach could draw on existing instruments in the EU macroprudential toolkit. Systemic risk buffers or risk concentration limits, in particular, could facilitate tackling climate-related financial stability risk in a targeted and scalable manner.

The report also looks in detail at how the degradation of nature potentially poses additional risks for financial stability. An in-depth look at the exposures of EU financial institutions suggests that 75% of bank loans and over 30% of insurer investments in corporate bonds and equity are in economic sectors heavily reliant on at least one ecosystem service, with particular dependence on services relating to surface and ground water, mass stabilisation and erosion control, and flood and storm protection.

The report follows three previous ECB/ESRB reports on climate risk and is part of the ECB's broader response to climate change.[1] On the prudential side, this includes the ECB's latest economy-wide climate stress test and its climate-related and environmental risk management expectations for supervised banks.

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[1] See "Positively green: Measuring climate change risks to financial stability", "Climate-related risk and financial stability" and "The macroprudential challenge of climate change", available on the ESRB's website.

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Notes

- The European Commission's Joint Research Centre (JRC) has also made a significant contribution to this report. Further information about the JRC's research on climate-related and biodiversity-related financial risk is available on their website.

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