Bank of England

The Lord Wood of Anfield
Chair
Economic Affairs Committee
House of Lords
London
SW1A 0PW

Andrew Bailey
Governor

24 June 2026

Dear Lord Wood,

I am writing to follow up on the questions posed by Lord Burns and Baroness Penn at the annual scrutiny session on 2 June related to the Bank's work on climate and nature. I welcome the opportunity to set out how these subjects sit within our statutory policy frameworks.

Climate change and the Bank of England's objectives

Climate change policy and actions to deliver the UK's climate change targets are for Government. Our role is to assess how climate-related developments and policy choices affect the macroeconomy, financial stability and the resilience of the firms we regulate, and to incorporate those effects into our frameworks in an appropriate way.

The Bank's **mission** is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. Our objectives are set by Parliament and our policy committees operate within remits set by Government, through the Remit and Recommendation Letters. In pursuing price stability, financial stability, firms' safety and soundness, and securing an appropriate degree of protection for insurance policyholders, the committees are also asked to have regard to the Government's economic policy, which includes the transition to a net zero economy.

My colleague, James Talbot, the Bank's Executive Sponsor for Climate, recently **outlined** our work in this space and why understanding climate driven shocks is essential to maintaining price and financial stability.

While we are at different stages across our different responsibilities, broadly speaking there are three phases to the Bank's work in this space:

1. Establish whether climate change is relevant to our objectives,
2. Quantifying the impacts where it is, and
3. Identifying how best to address these impacts to deliver on our objectives.

This letter will reflect those key points, and the progress we have made.

Monetary policy

Our monetary policy objective is set by Government and is defined as maintaining price stability, and subject to that, to support the economic policy of the Government, including its objectives for growth and employment. Price stability in this sense means the inflation target of 2 per cent.

As the impact of climate change and the transition begin to impact the macroeconomy and financial system, we, as policymakers, will need to understand these effects, just like any other shock. Climate change can affect the macroeconomy over relevant horizons through two primary channels.[1] Physical hazards can disrupt supply, demand, trade and productivity, with direct and indirect effects on UK prices. The green transition can shift relative prices, reallocate investment and change the sectoral composition of output. The Bank has led international work to analyse these channels, chairing work within the **Network for Greening the Financial System (NGFS)** on how climate affects the macroeconomy and monetary policy.

Our approach has two parts. First, working with the NGFS, we established a common assessment of how **physical impacts** and the **transition** can affect inflation and activity, over horizons relevant for policymakers.[2] In parallel, the Bank is developing our understanding of how the transition is likely to affect the transmission of energy price shocks to the UK macroeconomy. This includes monitoring the composition of the UK energy market, including how the mix of renewable and fossil fuel markets shapes prices in the UK wholesale energy market. In short, we think the aggregate share of renewable energy provision under fixed price 'contracts for difference' is likely to make energy costs less volatile.

As set out in my recent **speech**, the global economy has shown strong resilience despite heightened uncertainty, but the downside risks and headwinds to growth remain significant, and supply shock are becoming more frequent.

[1] **Climate change: possible macroeconomic implications | Bank of England**
[2] **Weathering the storm: stability in a changing climate - speech by Sarah Breeden | Bank of England**

Climate shocks sit squarely in both categories. As we move forward, if climate shocks become larger and more frequent, monetary policy may need to respond to offset inflationary pressures.[3] So, our work to understand these shocks better will be increasingly valuable over time.

Financial Stability

Our work on climate-related financial stability risks has moved from establishing relevance, to sizing impacts, to considering how best to address vulnerabilities within routine system monitoring.

Building on my colleague Sarah Breeden's leadership of the first suite of the NGFS reference scenarios, the 2021 **Climate Biennial Exploratory Scenario** was an important step for the Bank. The exercise represented our first effort to quantify the impacts of different climate scenarios on the largest UK banks and insurers – helping also to accelerate climate scenario analysis capabilities in the industry. It found that an early and orderly transition keeps system costs lower relative to late or no action pathways. Since then, Sarah has led work in the global Financial Stability Board (FSB) to produce an **analytical framework** to illuminate how climate-related vulnerabilities emerge and propagate through the global financial system.

As outlined in the Bank's recent Financial Stability Reports (**Nov 2024** and **Dec 2025**), we are now placing more emphasis on integrating climate risk assessment into our routine financial stability analysis. Examples of such **analysis** include improving our understanding of the impacts of potential system-wide asset repricing should investors begin to adequately price the likely climate transition, and further analysis of the exposures of UK banks to physical and transition risks.[4] We will continue to conduct targeted deep dives and scenario-based analysis where it is most decision-useful. This includes considering how climate-related risks should best be captured within our regular stress testing framework.

Prudential Supervision of Banks and Insurers

The PRA set **supervisory expectations (SS3/19)** in 2019 for how firms should manage climate-related risks - the first by a prudential regulator. Since the expectations were issued, banks and insurers have taken concrete and positive steps, but our assessment is that firms have more to do.[5]

[3] **The heat is on: why monetary policy makers are increasingly focusing on the impact of climate risks - speech by James Talbot | Bank of England**
[4] See analysis in the **December 2025 Financial Stability Report**, section 7.3.
[5] **PRA Climate Change Adaptation Report 2025**

Accordingly, and in response to industry feedback which requested greater clarity, in 2025 we updated the PRA's expectations for managing climate-related risk. This update was developed in light of the PRA's objectives, including the new secondary objective to facilitate the international competitiveness of the UK economy and its medium to long-term growth, as evidenced in the **Cost Benefit Analysis (CP10/25)**, which outlines the analytical case for these expectations.

The PRA's latest expectations, as set out in **supervisory statement 5/25**, are centred around a robust and credible assessment of risk, with financial institutions' boards taking clear ownership – treating climate risks like any other operational or financial risk – and managing them through their existing governance and risk arrangements. SS5/25 provides clear expectations on how firms should identify, assess, monitor and manage climate-related risks in a practical and proportionate way, including through using effective climate scenarios analysis. The expectations support firm resilience and allow them to make informed strategic decisions, including providing appropriate products that promote sustainable economic growth.

Setting clear expectations is the first step. Financial firms now need to ensure they implement the expectations by building capabilities, tools and best practice so that they can identify, measure and manage climate-related risk in practice. As part of that, with the FCA, we co-convene the **Climate Financial Risk Forum (CFRF)** to accelerate firms' capabilities to respond to climate risk in this evolving field. The CFRF has already tackled a broad range of issues, including recently launching a new industry-led Transition Finance Working Group taking forward the recommendation from the Government's **Transition Finance Market Review**.

Environmental risks

The Financial Policy Committee (FPC) has been asked to consider the materiality of nature-related risks as part of its remit, set by government, and the Bank is considering how to do this. Here we can build on the work of others. The NGFS has developed a **conceptual framework** and the **European Central Bank** has also published an assessment of these impacts for the euro area. Together these studies indicate there could be system-level risks, but they also highlight wide uncertainty about potential impacts on the financial system.

An important part of this work is assessing whether nature related risks are distinct from, or additional to, the climate related risks we already consider. In line with our approach to climate, we can consider whether the available evidence suggests there are material and proximate risks to UK financial stability.

Managing climate risks to our balance sheet

Consistent with the standards we set for firms, the Bank is also managing its own exposure to climate risks. We have increased haircuts and tightened **eligibility for mortgage loan collateral** in the Sterling Monetary Framework (SMF) to protect our balance sheet from energy price shocks and flood risks. These measures now cover over three quarters of SMF collateral. We have also developed an **approach to mitigate climate risk to corporate bond collateral**. Lastly, we have published an annual **climate disclosure** covering governance, strategy, risk, metrics and targets.

As I set out to the Treasury Select Committee, the global environment is currently marked by uncertainty alongside other risks that have moved up the agenda. Going forward we must look to balance resources across these full set of risks while continuing to integrate climate considerations where they are relevant to inflation, financial stability and firm resilience. In doing so, we apply a proportionate, risk-based approach that supports stability, competitiveness and growth.

That balancing act also reinforces the value of international collaboration so that the UK benefits from analysis and actions taken in other jurisdictions.

Yours sincerely,

Andrew Bailey