



BANK OF ENGLAND

Speech

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Introduction

The Accelerating America's Pledge report comprehensively documents the scale of change that is needed across our economies to put emissions on a trajectory consistent with building a net zero economy.

That will require a more sustainable financial system.

Changes in climate policies, new technologies and growing physical risks will prompt reassessments of the values of virtually every financial asset.

Firms that align their business models with the transition to net zero will be rewarded handsomely. Those that fail to adapt will cease to exist.

Now is the time to ensure that every financial decision takes climate change into account.

For that change to happen, we need to focus on the three Rs – reporting, risk management and return.

First, reporting

In 2015, G20 leaders tasked representatives from the public and private sectors to review how the financial system takes into account climate risks. We established a Task Force on Climate-related Financial Disclosures (TCFD), chaired by Mike Bloomberg.

Four years on, the TCFD has generated a step change in both the demand for and supply of climate reporting.

The demand for TCFD disclosure is now enormous. Current supporters control balance sheets totalling \$120 trillion and include the world's top banks, asset managers, pension funds and insurers.

The supply of disclosure is responding, with four fifths of the top 1100 global companies now disclosing climate-related financial risks in line with some of the TCFD recommendations. On every recommended metric in TCFD, disclosures have been steadily increasing. Three quarters of major investors surveyed are now using available TCFD disclosures when investing.

Mike Bloomberg's path-breaking initiative on climate disclosure is creating the platform to bring sustainable to the finance mainstream.

Now we must build on this foundation by:

First, over the next year, enhancing both the quantity and quality of disclosures to make TCFD standards as comparable, efficient and as decision-useful as possible.

And, by COP26, exploring pathways to make TCFD disclosure mandatory.

Second, risk management

For the market to understand where climate risks and opportunities lie, disclosures need to go beyond the static to the strategic. That means assessing the resilience of firms' strategies to transition risks.

This is hard. Only half of TCFD supporters systematically conduct scenario analysis and, of those that do, three fifths don't disclose it.

Fortunately, a number of promising initiatives are currently in train to build best practice.

First, TCFD case studies – from Rio Tinto to Unilever and Citi – detail characteristics of good scenario analysis.

Second, the TCFD Knowledge Hub provides guidance, research, tools, standards, frameworks and webinars.

Third, the Bank of England will become the first regulator to stress test its major banks and insurers against different climate pathways, including the catastrophic business-as-usual scenario, the ideal – but still challenging – transition to net zero by 2050, and the late policy action – or climate Minsky moment – scenario that could bring a sudden recognition of the scale of stranded assets.

Our stress test of the world's leading international financial centre will show how major financial firms expect to adjust their business models, and what the collective impact of these responses could be on the wider economy.

It will reveal the banks – and by extension companies – that are preparing for the transition to net zero as well as those who have not yet developed strategies consistent with America's Pledge or the UK's legislated commitment to net zero.

To take this approach global, we will share it with the 50 other central banks and supervisors in the Network for Greening the Financial System (NGFS) so that they can stress test their own financial systems, which cover two thirds of the world's emissions.

Finally, return.

The Paris Agreement calls on the financial sector to reorient financial flows in line with the two degree target.

Achieving this transition will require sustainable investment to go mainstream.

To do so, sustainable investment must do more than exclude incorrigibly brown industries and finance new, deep green technologies. Sustainable investing must catalyse and support *all* companies that are working to transition from brown to green.

To date, approaches to measuring and managing the financial implications of climate change for investments have been inadequate. Carbon footprints are not forward-looking, divestments only focus on the most carbon-intensive sectors, green investments are still small scale, and the impact of shareholder engagement is hard to measure.

One of the most promising options is to assess the “warming potential” of investment portfolios. For example, GPIF, the world’s largest pension fund, estimates that its assets are currently consistent with a 3.7 degree path.

Such a forward looking measure can help asset owners and asset managers understand the transition pathways of their investments and develop strategies to align financial flows with the necessary transition to net zero.

Degree warming will reveal who is on the right and wrong side of history. It will provide a signal to governments about where the economy is on the transition path and therefore the effectiveness of their policies.

It will empower consumers, giving them more choice in how to invest to support the transition.

With our citizens, particularly the young, demanding climate action, it is becoming essential for asset owners to disclose the extent to which their clients’ money is being invested in line with the values of those clients.

To this end, for COP26, the TCFD is establishing a subcommittee to consider how to standardise the methodology for measuring the warming potential of assets and expanding its use.

Conclusion

A market in the transition to a net zero world is being built. It will reveal how the valuations of companies could change over time as climate policies adapt and carbon intensity declines.

It will expose the likely future costs of doing business, of paying for emissions, and of tighter regulation.

It will help smooth price adjustments as society’s opinions and government policies change.

As countries build their policy track records and their credibility grows, the financial system will amplify the impact of those policies and pull forward adjustment to the net zero carbon future,

Consistent with the ambitions of America’s Pledge, the next year will be critical to mainstreaming sustainable finance.