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WS1 (Microprudential/supervisory workstream) mandate and workplan from 2018 to April 2020

Chair of the workstream: Ma Jun (People's Bank of China)
Composition: BaFin, Bank of England /PRA, Banco de España, Bank al Maghrib, Banque de France/ACPR, Bundesbank, De Nederlandshe Bank, European Central Bank, Finansinspektionen, Monetary Authority of Singapore.
Member of the Secretariat: Emilie Fialon (Banque de France)

During its January meeting in Paris, the NGFS agreed that WS1 will conduct a mapping of existing country experiences and supervisory practices, based on a broad definition of climate and environmental risks, taking into account the stock-taking exercises carried out by other groups such as the G20 Green Finance Study Group and the Sustainable Insurance Forum. The supervisory practices encompass, for example, climate and environmental information disclosure, corporate governance structures for sustainability issues as well as scenario-based risk analyses. Against the background of the current discussion within the European institutions on a Green Supporting/Brown Penalizing Factor, a stock-taking exercise of current national initiatives within this area will be carried out in three sub areas as set out below. Based on the work carried out by workstream 3 on taxonomy, an analysis will be performed to explore if there are empirical evidence for a differentiation of the financial risk associated with green/brown loans and investments.

1. **Conduct a mapping of current supervisory practices for integrating environmental (climate) risks into micro-prudential supervision.**

This mapping of supervisory practices will focus on physical and transition risks and include:

i) Environmental Risk Assessment (ERA): Methods and modelling techniques being used in the supervisory community to size the financial impact of climate and environmental risks to micro-prudential objectives and understand current barriers and challenges of effective use of ERA tools. This could include stress testing, scenario analysis and data issues.
ii) Integration into supervisory frameworks: How supervisors are currently engaging with regulated firms on climate and environmental issues, and considering the integration of these issues within their prudential risk frameworks (for example, into reviews of firms' management and governance, or risk management and controls).
iii) Capacity building and support: What activities are underway, or being considered, to support front-line supervisors, and policy colleagues, to factor in climate and environmental risks.
iv) Collaboration: How are micro-prudential supervisors collaborating with other financial supervisors/regulators, domestically and internationally, and wider stakeholders.

Based on the stock-taking exercise, explore options for how micro-prudential regulators can encourage financial institutions to integrate climate and environmental factors into financial decision making (e.g. by providing training, information sharing, organizing joint research via industrial associations, etc.), and how to put in place a governance structure within financial institutions (e.g. a board member in charge of the issue) that can motivate ERA analysis and risk management actions.

Consideration could also be given to refreshing the work of the G20 Green Finance Study Group on examples of ERA within financial institutions (particularly banks, insurers and asset managers) and wider market actors (credit rating agencies).

This part of the work will be led by the Bank of England.

2. **<u>Environmental information (climate risk) disclosure by financial institutions and options to encourage disclosure</u>**

Review the current practices in a number of countries (e.g. China, UK, France and Sweden) on environmental and climate information disclosure by banks and asset managers, taking into account the work carried out by the Task Force on Climate-Related Financial Disclosure (TCFD) and building on the TCFD disclosure pilot program organized by China Green Finance Committee and City of London and the one organized by UNEP, as well as the experience of French institutions under Energy Transition Law Article 173.

Discuss options and roadmaps for encouraging voluntary and/or mandatory disclosure of environmental and climate information (risk) by financial institutions.

This part of the work will be led by the Monetary Authority of Singapore.

3. **<u>Considering the extent to which a financial risk differential exists between 'green' and 'brown' assets.</u>**

   - Take stock of research projects (e.g. university experts) and possibly commission research to assess whether green/brown loans/bonds have lower/higher default probabilities than non-green/brown loans/ bonds, as a basis for exploring motives underpinning a risk differential between such investment that are consistent with financial mandate. As this task represents an extensive piece of work, the workstream could focus on specific asset classes such as on loans and bonds.
   - Map and critically assess specific tools that have been deployed by central banks/ supervisors or other relevant authorities to better reflect the risks for green/brown investments, and understand their micro-prudential risk implications, including pros and cons. Examples may include green-bonus points in Macro-Prudential Assessment scoring (implemented by PBOC in 2017), central bank relending to banks on green loans as collaterals (implemented by PBOC early 2018), adjustment to the risk-weighted asset calculation to reduce/increase the amount of capital required for green/brown loans/bonds held by banks, green QE operations.

This part of the work will be led by the People's Bank of China, working with BaFin.

The work of WS1 is expected to feed into the first NGFS progress report to be issued by April 2019.