EUROPEAN CENTRAL BANK

EUROSYSTEM

Christine LAGARDE
President

Ms Aurore Lalucq, Mr Eric Andrieu, Ms Maria Arena,
Mr Milan Brglez, Mr Cyrus Engerer, Mr Jonás Fernández,
Mr Niels Fuglsang, Mr Raphaël Glucksmann, Ms Sylvie Guillaume,
Ms Nora Mebarek, Mr Csaba Molnár, Mr Pierre Larrouturou,
Ms Evelyn Regner, Mr Sándor Rónai, Ms Marianne Vind,
Mr Pascal Canfin, Ms Margrete Auken, Mr David Cormand,
Mr Ignazio Corrao, Mr Jakop G. Dalunde, Mr Claude Gruffat,
Mr Pär Holmgren, Ms Alice Kuhnke, Ms Sylwia Spurek,
Ms Marie Toussaint, Mr Ernest Urtasun, Ms Manon Aubry,
Ms Leïla Chaibi, Mr José Gusmão, Mr Petros Kokkalis, Mr Emmanuel Maurel,
Ms Marisa Matias, Mr Dimitrios Papadimoulis, Ms Eugenia Rodríguez Palop,
Mr Stelios Kympouropoulos, Mr Fabio Massimo Castaldo, Ms Clara Ponsatí Obiols
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 26 March 2021

L/CL/21/40

Re: Your letter (QZ-006)

Honourable Members of the European Parliament,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs (ECON), accompanied by a cover letter dated 19 January 2021.

Let me first emphasise that climate change is very relevant to our mandate. As I noted in my recent letter to MEP Ferber[1], the scale and irreversibility of the consequences of climate change call for immediate action from all stakeholders, each within their own areas of competence. As I had the opportunity to explain in my recent appearance at the European Parliament plenary debate on the ECB Annual Report[2] and at my regular

[1] See "Letter from the ECB President to Mr Markus Ferber, MEP, on climate change", ECB, 5 February 2021, available at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter210205_Ferber~382cd05490.en.pdf?e7915a6f9a95415ad3c5142a605de1e8.

[2] See "Introductory statement by Christine Lagarde, President of the ECB, at the plenary session of the European Parliament", 8 February 2021, available at: https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210208~296c27d246.en.html.

hearings before the ECON Committee, as well as in my replies to recent letters from MEPs[3], we have already taken a number of concrete measures to this end across all of the ECB's areas of competence, particularly in the field of financial stability.

In relation to your first question, I would like to stress that the ECB has identified early on the potential systemic significance of the risks to financial stability stemming from climate change. As shown in a preliminary analysis published in the ECB Financial Stability Review, climate change-related risks have the potential to become systemic for the euro area, in particular since there are indications that markets are not pricing the risks fully.[4] A major reassessment of climate risk by markets could have substantial effects on the euro area financial system, including banks[5]. Against this background, the ECB has been taking concrete steps to strengthen the role of climate risk in both financial stability monitoring and banking supervision. Regarding the former, the ECB is integrating climate risk in financial stability monitoring by developing a state-of-the-art monitoring framework – as exemplified in a recent joint report of the Eurosystem and the European Systemic Risk Board (ESRB)[6] – as well as by integrating climate risk into the stress-testing framework. The ECB is currently developing a top-down climate stress test, and initial results for the euro area banking sector will be published by mid-2021.[7]

Regarding the supervision of individual banks, ECB Banking Supervision has already taken substantial steps to improve banks' awareness and preparedness to manage climate risks: most notably, it has recently published a Guide on climate-related and environmental risks explaining how it expects banks to safely and prudently manage and disclose these types of risk in a transparent manner under the current prudential framework.[8] In line with the supervisory expectations set out in the Guide, institutions are expected to incorporate climate-related risks into their risk management framework as drivers of existing risk categories. In accordance with the approach you mention in your letter, institutions are expected to adopt a comprehensive, strategic and forward-looking perspective in managing and disclosing climate-related and environmental risks. Institutions have a wide array of risk management tools at their disposal and can rely on a combination of appropriately calibrated instruments, both of a qualitative and quantitative nature. These may

3 See "Letter from the ECB President to Ms Eleonora Evi, Ms Rosa D'Amato, Mr Ignazio Corrao and Mr Piernicola Pedicini, MEPs, on monetary policy", ECB, 25 September 2020, available at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter200925_Evi_DAmato_Pedicini_Corrao~6fe5fb56d9.en.pdf.

4 See "Climate change and financial stability", *Financial Stability Review*, ECB, May 2019, available at: https://www.ecb.europa.eu/pub/financial-stability/fsr/special/html/ecb.fsrart201905_1~47cf778cc1.en.html.

5 See "Euro area banks' sensitivity to corporate decarbonisation", *Financial Stability Review*, ECB, May 2020 available at: https://www.ecb.europa.eu/pub/financial-stability/fsr/focus/2020/html/ecb.fsrbox202005_03~eaf7ae06be.en.html.

6 See "Positively green: Measuring climate change risks to financial stability", ESRB, June 2020, available at: https://www.esrb.europa.eu/pub/pdf/reports/esrb.report200608_on_Positively_green_-_Measuring_climate_change_risks_to_financial_stability~d903a83690.en.pdf?c5d033aa3c648ca0623f5a2306931e26.

7 For more information, see "Shining a light on climate risks: the ECB's economy-wide climate stress test", Blog post, ECB, 18 March 2021, available at: https://www.ecb.europa.eu/press/blog/date/2021/html/ecb.blog210318~3bbc68ffc5.en.html.

8 See "Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure", ECB, November 2020, available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf.

Address
European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal Address
European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu

include, among other things, adjusting financing and risk policies, conducting a constructive dialogue with their counterparties, and adapting monitoring and mitigation arrangements with a long-term view to improving the resilience of their portfolios. ECB Banking Supervision has already started supervisory dialogues with institutions on the basis of this Guide. Banks were asked to conduct a self-assessment in line with the supervisory expectations set out in the Guide and to draw up action plans on this basis. The ECB then intends to benchmark the banks' self-assessments and challenge them in the supervisory dialogue. In 2022, it will conduct a full supervisory review of banks' practices and take concrete follow-up measures where needed.

Regarding your question about the ECB's asset purchases, let me recall that the ECB is closely monitoring financial innovation that could support sustainable development. For instance, at the start of this year, bonds with coupon structures linked to certain sustainability performance targets became eligible as collateral for Eurosystem credit operations and for its asset purchase programmes.[9] In addition, the ECB has already taken steps towards incorporating sustainability considerations into its non-monetary policy portfolio. For example, the ECB has decided to use parts of its own funds portfolio to invest in the euro-denominated green bond investment fund of the Bank for International Settlements and to increase its share of green bonds in this portfolio over the coming years, including by direct purchases in the secondary market.[10] Furthermore, the ECB and the national central banks of the euro area have recently agreed on a common stance for climate change-related sustainable investments in non-monetary policy portfolios.[11] The ECB's ongoing strategy review provides an opportunity to further reflect on how environmental sustainability considerations are relevant in the pursuit of the ECB's mandate, including in relation to risk management.

In relation to your third question, the ECB subscribes to the view that climate-related risks can be a source of financial risk and to that extent it also falls within the mandates of central banks and supervisors to ensure the financial system is resilient to these risks.[12] Accordingly, as explained above, the ECB has already recognised the relevance of climate change for financial stability and has taken significant steps to integrate climate-related risks in its financial stability and banking supervision functions, in line with its mandate. The ECB's actions in the area of financial stability and banking supervision are in fact at the frontier of the global efforts made by central banks and supervisors in this area and are in line with international best practices, such as those developed by the Network for Greening the Financial System[13]. Within its mandate, the ECB is firmly committed

---

9 See the press release entitled "ECB to accept sustainability-linked bonds as collateral", ECB, 22 September 2020, available at: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200922~482e4a5a90.en.html.

10 See the press release entitled "ECB to invest in Bank for International Settlement's green bond fund", ECB, 25 January 2021, available at: https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210125~715adb4e2b.en.html.

11 See the press release entitled "Eurosystem agrees on common stance for climate change-related sustainable investments in non-monetary policy portfolios", ECB, 4 February 2021, available at: https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210204_1~a720bc4f03.en.html.

12 This view has been acknowledged by the Network for Greening the Financial Sector (NGFS). See "A call for action: Climate change as a source of financial risk", NGFS, April 2019, available at: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf.

13 See, for instance, "Guide for Supervisors: Integrating climate-related and environmental risks into prudential supervision", NGFS, May 2020, available at: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf; and "The Macroeconomic and Financial Stability Impacts of Climate Change Research Priorities", NGFS, June 2020, available at: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_research_priorities_final.pdf.

Address
European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal Address
European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu

to exploring every possible avenue through which it can further contribute to mitigating the risks stemming from climate change.

Yours sincerely,

[signed]

Christine Lagarde

Address
European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal Address
European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu