“The Bank of England must lead the way on climate change”

Open letter to Andrew Bailey

London, 3 March 2020

Dear Andrew Bailey,

Congratulations on your appointment as Bank of England governor. We wish you all the best in your new role.

You are taking up this post at a time when the financial system faces a reckoning with the climate crisis. This decade will be a period of profound upheaval, as markets react to extreme weather events occurring with greater frequency and further interventions by governments to curb emissions. We applaud the work you have done at the PRA and FCA to advance understanding of the challenges ahead.

To mitigate the worst effects of the crisis and meet the goals of the Paris Agreement, the transition to a zero-carbon economy must be urgently accelerated. Governments bear the primary responsibility for driving this shift, via regulation, taxes, subsidies and public investment.

Central banks also have an essential role to play. While governments have committed to limit the global temperature rise to as near as possible to 1.5°C, the financial system – as the Bank has previously warned – is still financing emissions that will trigger runaway warming that exceeds 4°C. Unless financial flows are urgently reoriented, our efforts to address the climate crisis have no chance of success.

Banks and insurers, and the financial system as a whole, face catastrophic consequences if they fail to adapt. If warming is left unchecked, extreme weather events will cause devastating losses. And if markets fail to anticipate regulation that makes future activity unviable, carbon-exposed firms and their supply chains could see a sudden and significant drop in value.

Central banks’ regulatory regimes and monetary policy operations can guide the reallocation of capital, so that markets are aligned with the Paris climate goals as quickly and smoothly as possible. Given the UK’s position at the crossroads of global finance, the Bank of England’s role is especially important.

The Bank already has a strong foundation on which to build. The first stress tests on climate risk will help to identify potential shortfalls in firms’ ability to withstand shocks, and force them, where necessary, to change course. The move towards comprehensive disclosures of climate risks by banks and insurance companies will make it easier for investors to assess their exposure, issuers to reprioritise their long-term investment strategies and for regulators to identify weaknesses across the system. This has been galvanised globally by the Task Force on Climate-related Financial Disclosures, and UK adoption has been encouraged by the PRA's new supervisory statement. The Bank has also pledged to disclose the climate-related financial risks across its entire balance sheet, we hope including assets purchased under its quantitative easing programme, which will set an important example to firms across the sector.

But due to the short time horizons of most actors and the methodological limitations inherent in quantifying climate risk, these measures alone are unlikely to be enough. This problem is outlined in the recent Bank of International Settlements and Banque de France publication, 'The Green Swan'. For as long as the financial system is aligned with a temperature rise beyond 1.5C, it is exposed to unacceptable climate-related financial risks, both from extreme weather events and the effects of future shifts in policy. For central banks to effectively discharge their duty to protect financial stability, they must use all the tools at their disposal to realign finance with internationally-agreed climate targets. With the UK hosting COP26 this year, the world is looking to you to lead the way.

We believe that three specific steps would help to put the financial sector on the right path. Firstly, the Bank should work with the government to put climate-related disclosures on a mandatory footing as soon as possible, in order to provide a comprehensive picture of the financial sector's exposure. Secondly, we urge you to lead by example, and pledge to exclude fossil fuel assets from the Bank's future bond purchases and collateral framework, starting with any exposures to coal. This will send a powerful signal that holding these assets undermines long-term financial stability, and is incompatible with the Paris goals. Finally, we urge you to consider adjusting the Bank's macroprudential framework, so that the risks associated with high-carbon loans are more accurately reflected in the amount of capital banks hold against them.

Given the implications of climate change and the low carbon transition for financial and price stability, the above actions clearly fall squarely within the mandate of the Bank. You can count on our support in your efforts to respond to the climate crisis, and we look forward to hearing about your plans.

Yours sincerely

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Miatta Fahnbulleh, chief executive, New Economics Foundation
Doug Parr, chief scientist and policy director, Greenpeace
Ulrich Volz, director, SOAS Centre for Sustainable Finance
Kate Levick, programme leader, E3G
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Rosalyn Schofield, member, Committee on Climate Change Adaptation Committee
Steve Waygood, chief responsible investment officer, Aviva Investors
Michael Izza, chief executive, Institute of Chartered Accountants in England and Wales
Martin Shaw, chief executive, Association of Financial Mutuals
Paul Nowak, deputy general secretary, Trade Union Congress
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