Towards macroprudential frameworks for managing climate risks

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What do we know about climate risks and financial stability

- Climate risks are potential systemic risks
- Climate systemic risks are likely to be underestimated
- Unfolding path of climate risks is key for the level of financial (in)stability
- An orderly transition starting now is the scenario that minimizes risks for financial stability
- An orderly transition starting now comes with frontloaded transition risks
Addressing climate risks with macroprudential policy

• Potential systemic risk requires adequate macroprudential policy response

• Holistic response, starting with sound micro prudential policy, is necessary

• Existing macroprudential policy toolkits can be deployed now to address climate systemic risks, although with possible adaptations to reflect their unique features

• Good macroprudential policy aims at

  1. Increasing resilience of financial system (absorption component)
  2. Mitigating the build up of systemic risk (containment component)
Systemic Risk Buffers– a tool available to European authorities

• SyRBs are a capital-based tool that has been used by national European authorities to address systemic risks with features like climate risks

• Principles of SyRBs for climate risks

  1. A component to absorb physical and transition risks – Function of individual and systemic exposure

  2. A component to mitigate the build-up of climate risk – Function of individual contribution to future systemic risk (i.e. contribution to the transition)

  3. A dynamic adjustment to the evolution of transition path
Blueprint for climate SyRB – Absorption and mitigation components

**Absorption component**
- Calibrated in terms of systemic resilience to climate risk exposure

**Containment component**
- Calibrated in terms of contribution to future risks

**Buffer for firms contributing to increasing future systemic risks**

**Buffer for firms contributing to mitigating future systemic risks**

**General or firm specific**

**Firm specific**
Blueprint for climate SyRB – Dynamic adaptation to transition path

2025 Starting point

2028 Orderly transition scenario

2028 Late and disorderly transition scenario
Implementation

• Link with concentration risk

• Margin of conservatism principle

• Progressive deployment as data and experience develop

• “Try-evaluate-adjust” approach with some tolerance for potential errors

• International coordination warranted but not necessary