Press release

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Current climate scenario analysis exercises may understate climate exposures and vulnerabilities, warn FSB and NGFS

The Financial Stability Board (FSB) and Network for Greening the Financial System (NGFS) published today a joint report outlining initial findings from climate scenario analyses undertaken by financial authorities to assess climate-related financial risks. The report draws lessons for effective scenario analysis and sketches out a global perspective. It has been sent to G20 Leaders ahead of the Bali Summit.

The report provides a synthesis of the findings from climate scenario analysis exercises undertaken by financial authorities at the individual firm level, at the level of the different financial sectors, and at the overall financial system level. It builds on the NGFS Scenarios in action progress report as an attempt to evaluate the implications of climate-change-related developments for the financial system as depicted in climate scenarios.

The report finds that the NGFS Scenarios play a critical role in providing reference climate macro-financial scenarios and supporting financial authorities' climate scenario analysis exercises. While a majority of these exercises rely on NGFS scenarios, significant variations in scope and objectives make it difficult to allow a straightforward comparison of results. However, taken together, the exercises provide a comprehensive picture on vulnerabilities. The overarching message from these initial exercises for financial stability is that, while the impacts of climate risks are not small, they seem to be concentrated in some sectors and overall, at least at this juncture and as currently assessed, contained from the perspective of domestic financial systems.

However, the report notes that tail risks and spill overs associated with climate change related developments may not be as manageable. In addition, measures of exposure and vulnerability are likely understated. Many exercises do not capture second-round effects, potential non-linearities in climate-related risks, and other potentially large sources of risk, such as those stemming from an abrupt correction in asset prices when transition shocks result in fire sales of assets in exposed sectors.

The report also finds that scenario analysis exercises at this stage are usefully feeding into policy discussions and are raising awareness. While critically contributing to risk assessment, the exercises are still considered exploratory and in most cases do not translate into micro- or macro-prudential policy action at this stage. Further progress on bridging data gaps, particularly on improving data availability and consistency/comparability at the global level, will be key. The report calls for greater cross-border cooperation – particularly at this early stage

of climate scenario analysis work. It notes that sharing knowledge and practices, in addition to the issuance of robust guidelines on how to conduct climate scenario analysis, would decisively support capacity building efforts, and stresses the important role that FSB, NGFS and other international organisations can play in that regard.

Klaas Knot, Chair of the FSB and President of De Nederlandsche Bank, said: “This joint report underscores the importance of work to enhance the understanding of the financial system vulnerabilities from climate-related risks, through improved and more forward-looking metrics for assessing financial institutions’ exposures to climate-related shocks. A key priority going forward will be to enhance the understanding of how first-round and second-round effects under different scenarios could give rise to financial stability concerns.”

Ravi Menon, Chair of NGFS and Managing Director of Monetary Authority of Singapore, said: “Climate scenario analysis is becoming an increasingly important tool for central banks and regulators to identify and assess climate risks in their economies and financial systems. The significance of these risks has been driven home by the global energy crisis unleashed by Russia’s invasion of Ukraine and the recent spate of extreme weather events. The NGFS will continue to refine its scenarios to be more relevant to a wider range of stakeholders.”

Notes to editors

The FSB’s Roadmap to address climate-related financial risks sets out a comprehensive and coordinated plan for addressing climate-related financial risks, including steps and indicative timeframes. The Roadmap covers four focus areas: firm-level disclosures, data, vulnerabilities, and regulatory and supervisory practices and tools. Expanding the use of climate scenario analysis and stress testing falls under regulatory and supervisory practices and tools. A progress report on the Roadmap was published in July 2022.

The FSB coordinates at the international level the work of national financial authorities and international standard-setting bodies and develops and promotes the implementation of effective regulatory, supervisory, and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with approximately 70 other jurisdictions through its six Regional Consultative Groups.

The FSB is chaired by Klaas Knot, President of De Nederlandsche Bank. The FSB Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.fsb.org.

At the Paris "One Planet Summit" in December 2017, eight central banks and supervisors established the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). Since then, the membership of the Network has grown dramatically, across the five continents to reach 140 Members and Observers (see Membership). Its purpose is to help strengthen the global response required to meet the goals of the Paris agreement and to enhance the role of the financial system in managing risks and mobilising capital for green and low-carbon investments in the broader context of environmentally sustainable development.

To this end, the Network identifies and promotes best practices and conducts analytical work on climate-related and environmental topics to support its Members' action.

The NGFS is chaired by Ravi Menon, Managing Director of Monetary Authority of Singapore. The NGFS Secretariat is hosted by the Banque de France in Paris, France.

For further information on the NGFS, visit the NGFS website, www.ngfs.net.