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NGFS publishes two new documents on climate-related risk differentials and credit ratings

Today, the NGFS released two documents that will aid central banks and regulators in their oversight of the financial sector and in their central bank operations:

- **“[Capturing risk differentials from climate-related risks](#)”**: Following up on a [Status Report published by the NGFS in May 2020](#), this report provides an update on existing analyses and practices in relation to green/non-green classification frameworks and the methodologies used by financial institutions (FIs), credit rating agencies (CRAs) and supervisors to assess and quantify financial risk differentials. The report draws on the experiences of 97 FIs comprising banks, insurance companies and development banks, and complemented by the perspectives of three CRAs.
- **“[Credit ratings and climate change – challenges for central bank operations](#)”**: Credit ratings are an important part of the information set of central banks for both monetary policy implementation and reserve management purposes. This report finds that credit ratings agencies already consider material climate-related risks in their assessments, where possible, but face significant challenges in adopting a more systematic approach to climate-related risk integration.

Ravi Menon, Chair of the NGFS and Managing Director of the Monetary Authority of Singapore: *“These two reports shed light on the extent to which climate risks are taken into account by financial institutions and affect credit ratings by rating agencies. This provides insights on how climate related risks in turn affect financial institutions’ pricing decisions and central banks’ monetary policy operations and reserve management activities.”*

Details on the report “[Capturing risk differentials from climate-related risks](#)”

Engagements with FIs, CRAs and supervisors revealed that there is still limited empirical evidence of ex-post green/non-green risk differentials and that conducting such analysis is not straightforward given persistent methodological and data-related challenges.

The work of the NGFS further suggests a decisive shift by FIs from a classification-based, backward-looking analysis of risk differentials at asset or activity level to a granular, risk-based forward-looking assessment of counterparties’ vulnerability to climate-related risks. CRAs’ integration of ESG factors in credit rating and related research findings also provides additional insight on advancing the analytical approach to assess the impact of ESG factors on creditworthiness.

Gek Choo Goh, Chair of the NGFS’ “Micro-prudential and Supervision” workstream and Executive Director of Banking Department II at the Monetary Authority of Singapore: *“The ability to quantify climate-related risk differentials on a forward-looking basis is critical to pricing such risks into financial institutions’ capital allocation decisions. An important input is the transition readiness of financial institutions’ counterparties,*

and the assessment of financial institutions' portfolio alignment with a science-based transition pathway. This will in turn enable financial institutions to take the right decisions in stewarding their counterparties' transition towards sustainable operations and in greening their own portfolios."

In light of these developments, the NGFS has identified three key strands of work for the supervisory community that could improve the resilience of FIs to climate-related and environmental risks:

- Supervisors could seek to further their understanding of the range of potential risk differentials as manifested through scenario analysis and stress testing (including at the individual FI's level).
- With a view to enhancing the management and monitoring of transition risk in a forward-looking manner, supervisors could examine the relevance and extent to which FIs should consider their counterparties' transition plans.
- Supervisors could further advance their understanding of the impact of environmental and climate-related risks on credit ratings and internal credit risk modelling at FIs.

Details on the note "Credit ratings and climate change – challenges for central bank operations"

Credit ratings play an important role in the operational frameworks of many central banks. The note investigates how and to what extent climate-related risks are incorporated into conventional credit ratings, highlighting the expectations and needs of central banks as users of such ratings. The report shows that - despite recent progress - there is still a lack of transparency surrounding the methodologies used by the rating agencies to incorporate climate-risk factors and how these factors contribute to the final rating.

Dr Sabine Mauderer, Vice-Chair of the NGFS and Member of the Executive Board of the Deutsche Bundesbank: *"Despite the considerable progress, there is still a lack of transparency surrounding both the methodologies used by rating agencies to incorporate climate risk factors and how these factors contribute to the final rating. I therefore encourage central banks to apply their own analysis to complement traditional credit ratings."*

About the NGFS

The NGFS, launched at the Paris One Planet Summit on 12 December 2017, is a group of central banks and supervisors, which on a voluntary basis are willing to share best practices and contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy. The NGFS brings together 114 central banks and supervisors and 18 observers. Together, they represent five continents and more than 85% of global greenhouse gas emissions, and are responsible for the supervision of all of the global systemically important banks and 80% of the internationally active insurance groups. The NGFS is chaired by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore. The Secretariat, headed by Mr Jean Boissinot, is provided by Banque de France.

For more details, visit the [NGFS website](#) and [Twitter account](#) or contact the NGFS Secretariat at Banque de France sec.ngfs@banque-france.fr

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