CDP and CDSB response to the Bank of England's Discussion Paper: The 2021 biennial exploratory scenario on the financial risks from climate change

CDP and the Climate Disclosure Standards Board (CDSB) would like to thank the Bank of England for the opportunity to provide feedback on the 2021 Biennial Exploratory Scenario (BES) on the financial risks from climate change.

CDP is a global environmental impact non-profit working to secure a thriving economy that works for people and planet. High quality, relevant information is the fundamental basis for action and CDP helps investors, companies and cities to measure, understand and address their environmental impact. The world's economy looks to CDP as the gold standard of environmental reporting with the richest and most comprehensive dataset on corporate and city action. CDP aims to make environmental reporting mainstream and provide the detailed insights and analysis to drive the urgent action needed for a climate safe, water secure, deforestation free world. CDP recognises the important role of the Task Force on Climate-related Financial Disclosures (TCFD) in mainstreaming climate-related information and advancing the availability of financially relevant information for global markets. Therefore, CDP has aligned its information requests with the TCFD recommendations, alongside introducing a sectoral focus and adopting a forward-looking approach to climate risk disclosure. We would welcome conversations on how we might support the Bank from a broader disclosure capacity building and data providing perspective.

CDSB is an international consortium of nine business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital. We do this by offering companies a framework for reporting environmental and climate information (the CDSB Framework) with the same rigour as financial information. In turn, this helps companies to provide investors with decision-useful environmental and climate information via the mainstream corporate report, enhancing the efficient allocation of capital. Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, our work builds the trust and transparency needed to foster resilient capital markets. The CDSB Framework is used by large listed companies globally and is referenced in government guidance to reporting regulation in the EU Commission Guidelines on Non-Financial Reporting, the UK Companies Act 2006, and stock exchange guidance in London, Australia, Singapore, Egypt, Santiago de Chile and elsewhere. CDSB has also contributed to the work of the UN Sustainable Stock Exchanges Initiative through its working groups on disclosure, green finance and financial regulators. CDSB also hosts the TCFD Knowledge Hub on behalf of the G20 Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), which helps report preparers to find the resources they need to understand and implement the TCFD recommendations.

Collectively, CDP and CDSB aim to contribute to more sustainable economic, social and environmental systems.

We applaud the Bank of England for the leadership it has shown on working towards tackling climate risk and safeguarding financial stability. We welcome the Bank's plans to conduct this test on the financial system's preparedness for the transition and physical risks posed by climate change and stand ready to support the Bank in its efforts. We have set out our response to this discussion paper, both overall and relating to the questions as listed in Annex I. below.

Jennie Gleed
Senior Policy Manager
CDP

Michael Zimonyi
Policy & External Affairs Director
Climate Disclosure Standards Board

Annex I: Responses to consultation questions

Overall comments on the Discussion Paper

We believe that this proposal is both feasible and robust and sets out a strong pathway to deliver the overarching objective of the 2021 BES being to "*test the resilience of the current business models of the largest banks, insurers and the financial system to the physical and transition risks from climate change."*

Our overarching feedback relates to the desired outcomes of the BES, as outlined on page 4 of the Discussion Paper:

- *"Size the financial exposures of participating firms and the financial system more broadly to climate-related risks;*
- *Understand the challenges to participants' business models from these risks, gauge their likely responses and the implications this carries for the provision of financial services. This includes investigating the interdependency between insurers and banks, namely the impact of potential changes in insurance provision on banks' credit risk exposures; and*
- *Assist participants in enhancing their management of climate-related financial risks. This includes embedding these risks in business-as-usual risk management, engaging counterparties to understand their vulnerability to climate change, and encouraging boards to take a strategic, long-term approach to managing these risks".*

Firstly, we are concerned that the underlying assumption in all three scenarios that limiting global average temperature increases to below 2°C is moderate and would not result in significant financial and societal shocks. Though the impacts of global warming vary according to a complex host of factors, the climate-related risks for natural and human systems are significantly lower at 1.5 than 2°C. We have elaborated on this point in our answer to Q3 below.

Secondly, we support the Bank's intention to make enough information available in the published scenarios to allow other firms to complete the exercise as part of their own scenario analysis work, even if they are not covered by the scope of the BES.

However, in that regard, the discussion paper also notes that "The Bank does not intend to disclose the results for individual firms." We believe that firms should not be discouraged, but proactively encouraged to disclose the outcome of their scenario analysis if they wish to do so voluntarily. CDP provides a platform for Financial Institutions to do this, and in so doing, provide valuable information to their stakeholders. We encourage the Bank to explicitly state that Financial Institutions are free to disclose this information voluntarily. We believe this will particularly be of use in helping to achieve the third desired outcome as listed above to *assist participants in enhancing their management of climate-related financial risks*, as well as providing more information for other actors in support of more accurate pricing of risks.

Thirdly, we applaud the Bank for its international engagement to support this work, including its role as a founding member of the Network for Greening the Financial System and active supporter of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). CDP and CDSB are supporters of both initiatives and believe that regulatory requirements to implement TCFD recommended disclosure is essential to create multiple economic benefits and help to accelerate the low-carbon and climate-resilient transition.[1]

Answers to questions on Chapter 2: Key features of the 2021 BES

Q1. **Are there areas of the financial system that should be represented in the 2021 BES that are not captured by the proposed participation?**

Given the interconnected nature of the financial market, it would be prudent to use a more complete scope of financial participants. This would provide a more accurate picture for example of asset pricing in a case where many firms sharply reduce their exposure to certain asset classes in a scenario. In this case asset prices could either drop further as a result of asset managers reacting the same way. We therefore recommend that large asset owners and asset managers should be covered by the BES. While we recognize that the PRA does not directly regulate asset managers, we believe that the PRA should work with the appropriate authorities, such as the FCA, to include asset owners and asset managers in the exercise. The FCA's proposed climate-related financial disclosure listing requirements, currently under consultation[2], could perhaps provide a pragmatic vehicle for this exercise. Some asset managers and asset owners will already be included as they are submitting at UK group consolidated level with the group having insurance/banking arms. CDP 2019 disclosure responses also show that asset managers already conduct scenario analysis: Globally, out of 81 asset managers, 30 (37%) disclosed that they conduct scenario analysis. This includes almost half of the asset managers headquartered in the UK (7 out of 16).

Q2. **Do firms envisage any challenges with modelling the no additional policy action scenario spanning 2050–80?**

Climate models are continuously being updated, and a number of the newer ones have a higher climate sensitivity. With this in mind, CDP recommends that there is a robust and as up to date as possible approach to modelling when physical risks will occur under the 'no additional policy action'.

Answers to questions on Chapter 3: Scenario narratives

Q3. **Are there any other scenarios that the Bank should be testing as part of the 2021 BES?**

The IPCC Special Report on 1.5°C [3] revealed that 2°C of warming above pre-industrial levels poses greater risks than previously believed, but that these risks can be substantially reduced by limiting warming to 1.5 degrees. Climate models show that 1.5 rather than 2°C would mean:

- Less extreme heat in most regions, smaller increases in frequency and intensity of heavy precipitation in several regions, and lesser probabilities of drought in some regions;

[1] CDP & CDSB, Roadmap for Adopting the TCFD Recommendations. Accessed online: ://www.cdsb.net/sites/default/files/roadmap_for_adopting_the_tcfd_recommendations.pdf
[2] Financial Conduct Authority (2020) CP20/3: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations. [Online]. Available at: https://www.fca.org.uk/publications/consultation-papers/cp20-3-proposals-enhance-climate-related-disclosures-listed-issuers-and-clarification-existing
[3] IPCC (2018), Global Warming of 1.5°C - An IPCC Special Report. Accessed online: https://www.ipcc.ch/sr15/

- Sea level rise by the end of century 0.1m lower, meaning that 10 million fewer people exposed to related risks; and
- Halving the area of land that would undergo an overhaul of their precious ecosystems, which is expected to be 13% of all land at 2°C.

Restricting global warming to 1.5°C instead of 2°C also reduces the chance of reaching potentially irreversible thresholds, such as melting of the permafrost or collapse of the Greenland ice sheets. These "tipping points" could induce cycles of ever-increasing temperatures and compounding impacts for people and planet.
Societally, limiting warming to 1.5 instead of 2°C is estimated to:

- Reduce the number of people both exposed to climate-related risks and susceptible to poverty by up to several hundred million;
- Lower the proportion of the world population subjected to climate change-induced water stress by 50%;
- Result in smaller net reductions in yields of key crops such as maize, rice and wheat; and
- Limit the expected increase in risks from vector-borne diseases like malaria and dengue fever, which currently cause more than 700,000 deaths annually.[4]

Significantly, the special report lowers the temperature of warming at which the world will face high levels of risk of "global aggregate impacts", such as global monetary damage, global-scale degradation and loss of ecosystems and biodiversity.

Given that a 2°C pathway may result in large-scale, significantly dangerous shocks to the UK's financial system and its citizens, we strongly recommend applying both the early policy action scenario and a late policy action scenario in line with a 1.5-degree pathway.

From the perspective of acceptability for Science-Based Target setting, the Science-Based Targets initiative do not accept scenarios P3 or P4 of the IPCC 1.5 report, or other scenarios characterized by a high fossil fuel mix combined with unrealistically large expansion carbon dioxide removal measures. In this vein, we would welcome further clarity on the proposal to take a conservative approach to the sensitivity of temperature to increases in emissions, as set out in paragraph 2.7. In order to take a prudent approach to this stress testing and to effectively protect the UK market's stability, as well as ensuring the well-being of UK households and businesses, we urge the Bank to err on the side of caution and take into consideration a higher than expected sensitivity of temperature to increases in emissions.

Q4. **Do the scenario timeframes strike the right balance between allowing a full assessment of these risks while also being tractable for firms' modelling?**

We recommend that the modelling horizon for scenario analysis should be on the decadal scale but note that the most appropriate horizons depend on the sector.

We also suggest that the modelling horizon of the scenarios should extend to 2100 and incorporate all anthropogenic emissions, in order to account for the climate system over the course of the Paris Agreement.

[4] World Health Organization (2017), Vector-borne diseases. Accessed online: https://www.who.int/news-room/fact-sheets/detail/vector-borne-diseases

Many energy system scenarios model out to around mid-century and leave non-energy related greenhouse gas emissions exogenous. For example, the International Energy Agency's 2°C Scenario (2DS), Below 2°C Scenario (B2DS) to 2060, and Sustainable Development Scenario (SDS) to 2050. These scenarios are less preferable but provide greater sectoral granularity.

Answers to questions on Chapter 4: Scenario specification

Q5. **Does the scenario specification adequately capture the risks in each scenario? Are there additional risk channels or scenario variables that should be considered as part of the BES?**

While the "too little, too late" scenario does highlight the heightened physical risks as transition is insufficient for the world to meet its climate goal of staying below 2°C, none of the scenarios explicitly refer to tipping points. However, tipping points can cause additional sudden or irreversible change and exacerbate temperature rises. We encourage the Bank to ensure that the potential impacts of tipping points are taken into account in the relevant scenarios.

Q6. **Are there alternative approaches to capturing the interactions between physical and transition risks, including capturing the impact of stranded assets?**

We have no comments on this matter.

Q7. **Are there particular external sources to calibrate physical and transition risk impacts that the Bank should consider when calibrating the scenario variables?**

We have no comments on this matter.

Q8. **Are there particular external sources or approaches that the Bank should consider when relating long-term macrofinancial variables to climate variables?**

We have no comments on this matter.

Q9. **For life insurer liabilities, are there further risks beyond longevity that should be specified as part of the BES?**

We have no comments on this matter.

Answers to questions on Chapter 5: Modelling approaches

Q10. **Are there data gaps or modelling deficiencies that would impede participants' ability to model the scenarios? How would participants reflect judgements about companies' current mitigation and adaptation plans in their quantitative assessment?**

For current mitigation plans, participants could consult CDP corporate disclosures[5], CDP corporate scores[6], the Science-Based Targets initiative[7], or assessments undertaken using the Assessing the low-Carbon Transition (ACT[8]) methodology.

Participants could leverage CDP disclosures, which are aligned with TCFD recommendations. Around three quarters of the universe of over 2,300 publicly listed companies responded to the

[5] https://www.cdp.net/en/data
[6] https://www.cdp.net/en/search
[7] https://sciencebasedtargets.org/
[8] https://actproject.net/

majority of TCFD-aligned questions within CDP's information request in 2018, with a quarter of these responding to all of them. In 2019 disclosures, the share of companies responding to all TCFD-aligned questions looks set to rise.

In 2020 CDP launched its first questionnaire focusing on publicly listed financial services companies. CDP already works with major investors and financial institutions, many of whom disclose the direct climate impacts of their operations. This year, CDP will also gather data on the environmental impacts these companies finance in the wider economy.

CDP's new questionnaire on financial services fills a critical data gap on climate reporting, as identified by the industry-led Task Force on Climate-related Financial Disclosures (TCFD). The TCFD has specifically highlighted that the financial services sector needs to be seen as producers of data, as well as users.

The information gathered will include:

1. The lending, investment and underwriting portfolios of companies in the financial services sector;
2. The steps asset managers, banks and insurance companies are taking to assess their portfolio's exposure to climate-related risks and opportunities;
3. Whether companies are actively engaging with their clients and investees on climate-related issues;
4. Whether climate-related information is requested during initial due diligence and risk assessment practices with clients and investees;
5. Whether companies integrate climate-related issues into their existing policy frameworks, for example implementing climate-related exclusions when lending, investing or underwriting insurance;
6. Whether companies are conducting analysis to understand how their portfolio impacts the climate, particularly whether they calculate and report the emissions affiliated with their portfolio, also known as "Scope 3 emissions (Category 15 "investments)";
7. To what extent the company's portfolio is aligned with the Paris Agreement's goal of a well below 2-degree world.

Science-based emissions reductions targets (SBTs) provide companies with a clearly defined pathway to future-proof growth by specifying how much and how quickly they need to reduce their greenhouse gas emissions. SBTs are validated and approved by the Science-Based Targets initiative against sectoral decarbonisation pathways.

In addition, The Science Based Targets initiative is developing criteria and resources for financial institutions to set emissions reduction targets covering the emissions associated with their investment and lending activities. More than 50 financial institutions have already publicly committed to setting science-based targets.

The ACT scoring approach incorporates physical asset data to assess transition and physical risks of assets in high impact sectors and this data also enables an understanding of geographical sensitivities, stranded assets and near-term performance against scenario benchmarks.

Q11. **Would participants be able to assess 80% of their corporate counterparties at counterparty level, leveraging the tools set out in Annex 2 and expert judgement?**

We have no comments on this matter.

Q12. **Does the proposed approach to modelling future risks at each reporting point work for both the modelling of credit and market risk? Does the reporting framework, in particular the frequency of five-yearly reporting points, adequately capture the evolution of risks over time? Might more frequent reporting be useful for some parts of the scenarios, for example, during the transition in the late policy action scenario?**

We agree that more frequent reporting may be useful in some parts of the scenarios, as outlined in the example, and suggest that three-yearly reporting points are considered.

Q13. **What are insurers' views on how to assess underwriting portfolio liabilities to key territories/perils? The Bank welcomes insurers' views on key territories/perils to be explored.**

We have no comments on this matter.

Answers to questions on Chapter 6: Firm submissions

Q14. **Given the suggested timetable for the BES, is 30 June 2020 the latest cut of balance sheet data that firms can submit? Is three to four months sufficient time for participants to the run the BES?**

We have no comments on this matter.

Q15. **Would the proposed outputs accurately capture the climate-related financial risks faced by participants and achieve the objectives of the BES?**

We would welcome an additional output focusing on an analysis of how much and what kind of assets financial institutions plan to sell to limit exposure to climate-related risks, and when and how they plan to sell these assets. This can help to determine major tipping points.

Q16. **Do participants have access to data and tools to enable them to estimate the temperature alignment of their current asset holdings? Which asset classes should be included in this calculation?**

Significant change could be driven by financial institutions using portfolio rating tools that link to the ambition and targets within the real economy with different temperature scenarios. The Science Based Targets initiative (SBTi) has developed, introduced and applied such protocols to over 300 companies that have submitted targets for validation by the SBTi.

CDP intends to assess the ambition of corporate targets disclosed via CDP and to assign temperature ratings to individual corporations based on the ambition of their targets. Translating corporate targets into a single common metric will enable CDP to assess temperature alignment of investment portfolios, indices, funds, procurement portfolios and others using a forward-looking approach.

Q17. **Do five-year reporting intervals pose challenges to participants that are not reflected in this discussion paper?**

We have no comments on this matter.

Q18. **Are there additional changes that should be modelled in the second round that would allow the Bank to better understand systemic climate-related risks?**

We have no comments on this matter.

Q19. **Would life insurers prefer to provide Solvency Capital Requirement and percentage capital coverage as part of the scenario outputs?**

We have no comments on this matter.