

**Contribution of the *Network of Central Banks and Supervisors for Greening the Financial System (NGFS)*
to the *United Nations' Conference of the Parties (COP26)*
Pledge by the Central Bank of Chile
October 2021**

I. Our Involvement with the NGFS

Climate change, a paramount global threat, is increasingly becoming a relevant factor to consider in economic policy and financial regulation. In fact, the greening of the financial system is a key piece in fostering a more efficient and less costly transition towards the net-zero carbon emission target. The global nature of this threat, compounded with uncertain, non-linear, and long-term impacts, underscores the utmost importance of coordination among jurisdictions. The role of the NGFS in this regard has been extremely valuable, not only by allowing for knowledge exchange, but also by promoting engagement of regulators and supervisors around the world. There are multiple challenges, primarily derived from the difficulties to measure climate-related risks. Again, the efforts of the NGFS to identify the large data gaps and lack of transparency have been an instrumental step towards improving risk assessment. More so with the development of the climate scenarios and the accompanying research agenda.

The Central Bank of Chile (BCCh)'s involvement with the NGFS begins in early 2021. In addition to plenaries, the BCCh participates in three working groups (WG), more intensely in WG2 (scenarios) because of earlier involvement, but also more recently in WG4 (data gaps) and WG5 (research). With respect to the latter, the BCCh is actively participating in the agenda to incorporate biodiversity risks into macroeconomic analysis.

Different divisions of the BCCh act as counterparties in each group. Namely, the Statistics Division, led by Ms Gloria PEÑA is the main team involved in issues related to data gaps; the Monetary Policy Division, whose Director is Mr Elías ALBAGLI, participates in the research working group; and finally, the Financial Policy Division, directed by Ms Solange BERSTEIN, has been contributing with the scenarios and agenda of the WG2.

With regards to the commitments set forth in this pledge, and in addition to leveraging from the work being led by the NGFS, the BCCh shall continue its cooperation and coordination efforts in the areas of macroeconomic and financial analysis and research, regarding other domestic authorities in charge of the regulation and supervision of the financial system and the capital markets, having due consideration for the mechanisms and agreements currently available for said purposes.

II. Involvement with the NGFS recommendations

NGFS A Call for Action's Recommendation No. 1: Integrating climate-related risks into financial stability monitoring (and micro-supervision)

1. The BCCh committed its participation in the pilot exercise led by the NGFS WG2. The expert team at the BCCh has been working in designing a bottom-up climate change stress-test exercise. The proposed test consists of estimating the impact on about 200 thousand firms' balance sheets and probabilities of default resulting from a shock to carbon prices and the effects of an increase in the occurrence of natural disasters such as droughts, wildfires, and floods. The methodology will make use of the NGFS climate scenarios that involve a 100 USD tax increase per ton of carbon. The aim is to have preliminary results by 2022Q2.

In addition, the BCCh is working jointly with the *International Monetary Fund* on climate change stress tests for transition risks. This ongoing effort complements the one with NGFS and will strengthen the BCCh's ability to monitor climate-related risks facing the financial system.

2. The BCCh commits to building awareness of climate-related risks among the financial institutions of the Chilean markets, through its traditional financial policy documents and the *Financial Stability Reports* (FSRs), considering the scope of its legal mandate and authority. More concretely, the BCCh commits to setting out a frequent analysis of climate-related risk in its FSR. Along this line, one of the forthcoming (2022) specific analysis chapters of the FSR will be dedicated exclusively to the topic.
3. The BCCh will continue to work jointly with financial authorities and financial institutions, maintaining its autonomy and circumscribed to its legal mandate and authority, to better understand the climate-related risks to the financial system and the economy related to a transition to a low carbon-net-zero economy and physical effects of severe and more frequent climate events.

It is worth noting that the BCCh does not have a supervisory mandate. It is the role of the *Comisión para el Mercado Financiero*¹ (CMF) to supervise banks, and other financial institutions, and enforce legal and regulatory requirements, including those issued by the BCCh.

NGFS A Call for Action's Recommendation No. 2: Integrating sustainability factors into own-portfolio management

4. The BCCh is committed to further studying the integration of green bonds as part of its own portfolio, as well as revising its investment process in order to take into consideration Environmental, Social, and Corporate Governance (ESG) criteria in the long term. It should be noted that this is part of a long-term agenda that needs to be consistent with the strategy of the BCCh—adopted in accordance with the applicable legal framework—, and with the developments in the different Divisions of the BCCh. Understanding the implications of this strategy, its impact on the portfolio, among other issues, is a matter of the Board of the BCCh. The Board is aware of the importance of being fully informed and, hence, of committing to improve the institution's knowledge on these matters.
5. The BCCh will continue to monitor structural market developments in sustainability products and stands ready to support innovation in the area of sustainable finance within the scope of its mandate, as exemplified by, among others, the decision of accepting sustainability-linked bonds as collateral in the different programs under which the BCCh interacts with the financial markets, as well as analyzing their treatment under different risk management measures.
6. The BCCh is committed to integrating sustainability considerations into monetary policy. The main objective of the medium-term research agenda, to be presented by year-end, is to incorporate climatic and, more broadly, environmental concerns into its standard toolkit for macroeconomic analysis, including the effects of physical and transition risks. In terms of long-run issues, the agenda will assess the impact on long-run potential growth, a key parameter for anchoring its medium-run projection models. Thus far, these estimates have not considered the costs associated with changing the energy supply matrix coherent with achieving climate goals (carbon neutrality in 2050); changes in international taxes

¹ *Financial Markets Commission.*

associated with export activities; nor the expected costs and risks associated with physical damages, particularly relevant for certain sectors such as real estate, mining, agriculture, and fishery.

In terms of short/medium-term issues, the agenda will include satellite macroeconomic forecasting models, to assess relevant sectoral changes as well as inflationary pressures that may lie in the near future—for example, derived from scenarios in which both energy and food prices start showing sustained upward trends in the next few years (i.e., not decades), in line with the more ambitious transition commitments that appear to be building up in the international climate discussion.

NGFS A Call for Action's Recommendation No. 3: Bridging the data gaps

7. The BCCh is committed to addressing the numerous analytical and quantitative challenges inherent in the research agenda that aims at incorporating sustainability considerations to financial and monetary policy.
8. In the short term, the BCCh will continue disseminating yearly direct CO₂ emissions and carbon footprint for economic activities according to the National Accounts' breakdown.²
9. The BCCh is currently developing a new research agenda focusing on climate-related topics to enhance available data: (i) identifying the main drivers (scale, product mix, and technology) of overall CO₂ emissions; (ii) the distributive consequences of a green tax implemented in 2017 (USD 5 per ton of CO₂ emitted) on households' expenditure, and (iii) the effect of the green tax on firms' CO₂ emissions. The results of these studies are estimated to be released in the next two years.
10. In line with the previous commitments, the Board of the BCCh recently decided to join the *Natural Capital Committee*, together with the Ministry of the Environment and the *National Council of Innovation for Development* (CNID).³ The purpose of the committee is to design a medium-term plan to assess the value of natural capital according to international guidelines and develop methodologies for quantifying in a systematic and comparable manner the impact of different economic activities and projects on the environment.

NGFS A Call for Action's Recommendation No. 4: Building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing

11. In order to give continuity to this work, the BCCh commits to keep on using the relevant NGFS materials, tools and guides. Also, it commits its best efforts towards using the NGFS training material to equip its employees with the necessary skills and knowledge on climate-related risks, with a view to efficiently implementing the recommendations of the NGFS.
12. The BCCh is willing to share its acquired knowledge on building carbon footprint statistics with other NGFS members.

² See <https://www.bcentral.cl/contenido/-/detalle/estudio-economico-estadistico-n-135>.

³ See press release: <https://www.bcentral.cl/en/content/-/details/central-bank-of-chile-decided-to-join-the-natural-capital-committee>.

13. Reporting on Commitments the BCCh commits that progress on the above actions and potential future ones will be publicly communicated as part of the BCCh's corporate annual reporting frameworks and products (e.g., *Memoria Anual del Banco Central de Chile*)⁴.

III. Other Initiatives related to climate risk

14. The BCCh participates actively in several international organizations, including the *Financial Stability Board* and the *Bank for International Settlements*. Regarding the latter, the BCCh participates in the "*Task force on incorporating climate-related risks into international reserves management framework*" and regularly monitors strategic risks that may impact the BCCh.

⁴ The BCCh's *Annual Report*.