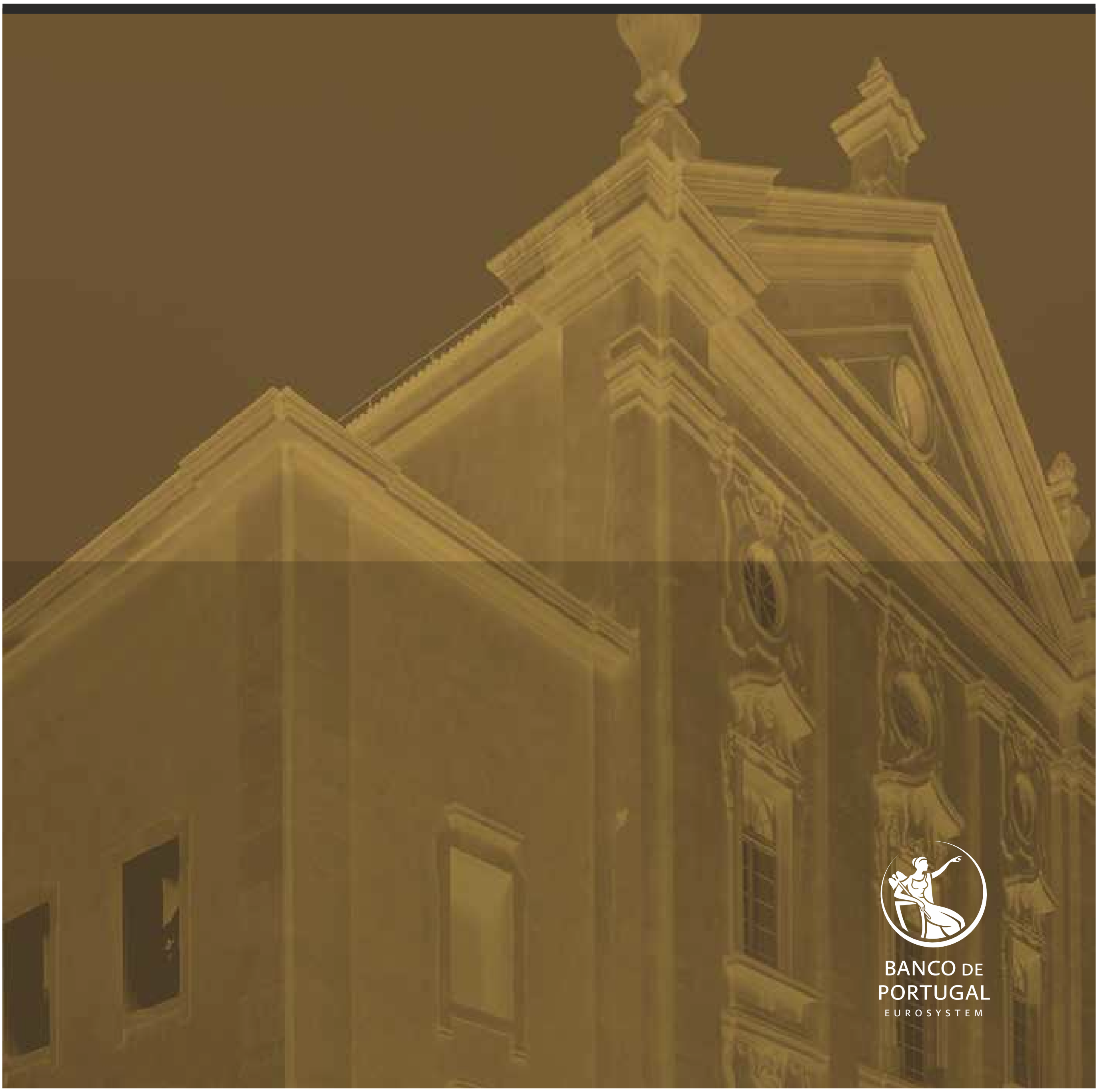
BANCO DE PORTUGAL'S COMMITMENT TO SUSTAINABILITY AND SUSTAINABLE FINANCE



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Governor's message

As an institution whose main mission is to maintain price stability and promote the stability of the financial system, Banco de Portugal is, by its very nature, committed to the sustainable economic and social development of our country. As such, Banco de Portugal is not only committed to the dimensions of sustainability more directly related to its role as central bank – macroeconomic and financial sustainability – but also to sustainability in a broader sense, namely environmental, social and governance sustainability, which affect and determine how it pursues its mission.

Without environmental, social and governance sustainability, macroeconomic and financial stability will always be at risk.

Banco de Portugal has consequently established safeguarding the quality of governance as one of its key objectives both in monitoring the business models of supervised institutions and in the fit and proper assessments of the members of their management bodies.

Social sustainability concerns are also at the heart of how Banco de Portugal carries out and organises its activities and interacts with the community. This outlook must also feature in the monitoring and analysis of macroeconomic developments, given that merely checking whether fundamental economic balances are in place is not sufficient. It is essential to evaluate to what extent a feeling of inclusion and wide distribution of the benefits of growth has been socially safeguarded; this is key to the soundness and durability of the progress made so far.

Nevertheless, environmental sustainability should be first and foremost among the dimensions of sustainability. Indeed, without environmental sustainability, economic agents would collapse, taking with them production and income-generating systems as well as mechanisms for the allocation and reproduction of accumulated savings.

The main challenge for macroeconomic and financial stability is having a long-term vision, thereby preventing the accumulation of irreversible tensions and risks. For Banco de Portugal, this challenge affects how it acts as supervisor and how it manages its investment portfolio. On the one hand, as supervisor, the Bank is responsible for helping financial institutions gain a broader understanding of their counterparties' risk profile, be they firms or individuals, so as to be able to differentiate credit cost and supply according to the sustainability risk of each business model and the resulting externalities. This should not be achieved through subsidisation, but rather by internalising the economic and social costs arising from the degree of unsustainability of financed entities and activities. On the other hand, as holder of a substantial investment portfolio, Banco de Portugal must analyse and select investment alternatives according to the risks they entail to the various dimensions of sustainability.

Banco de Portugal's commitment to sustainability is also reflected in its internal management, i.e. in how it carries out its activities and provides the general interest services under its charge. It has therefore adopted measures in order to be increasingly environment-friendly and to raise awareness of sustainability issues, namely as regards financial management and resource allocation.

This is the vision that is embodied and nurtured in *Banco de Portugal's Commitment to Sustainability and Sustainable Finance*, which looks back on the progress made so far and embraces the road ahead towards sustainability.

Carlos da Silva Costa

Executive summary

By preparing this *Commitment to Sustainability and Sustainable Finance*, Banco de Portugal reaffirms its dedication to this issue. It mainly provides a starting point from which the Bank may structure the cross-cutting and integrated contribution it can and should make to global efforts to meet the challenges posed by sustainability issues – particularly climate change, one of the main global concerns of our time.

Chapter 1 ('Background') presents a broad panorama of the issue by providing some of the most important references to understand how the main phenomena and concepts of sustainability have developed. More recently, the Millennium Development Goals and the Paris Agreement on climate change are seen as particularly relevant, in addition to other initiatives undertaken or coordinated by institutions such as the European Commission, the Financial Stability Board (FSB), and, at national level, the Ministry of Environment and Climate Action (MAAC).

Chapter 2 ('Role of central banks and supervisory authorities') highlights how the community of monetary and supervisory authorities as a whole approaches the subject when faced with issues that also affect these authorities. An overview of how a number of relevant institutions have dealt with this issue is provided. Moreover, two particularly significant approaches to the field are emphasised: identifying, assessing and managing financial risks emerging from climate change and the channels that may be used by central banks and supervisory authorities to help strengthen sustainable finance, in line with their mandates and the applicable prudential regulatory framework.

Chapter 3 ('Current state of play at Banco de Portugal') focuses on how the concept of sustainability (covering the environmental, social and corporate governance dimensions of sustainability) and the phenomenon of climate change are cross-cutting. Accordingly, this chapter enumerates a few different ways in which the Bank is faced with the issue, especially in the fields of financial stability, banking supervision, economic research, asset management, and in its role as a corporation.

Chapter 4 ('Focus areas') naturally follows on from this general review of the current situation, by listing priorities for future intervention and providing a context for specific initiatives, in order to give substance to the Bank's commitment to this issue. Focus is therefore placed on the identification and assessment of climate-related risks, the adoption of sustainable internal practices, domestic and international intervention, and communication and cooperation both within and outside the Bank.

1 Background

The notion that the planet's natural resources are scarce and finite is relatively old.[1] However, in the past few decades this idea has seen unparalleled dissemination, thus taking on unprecedented importance and urgency. As a result, several concepts that are central to an understanding of the phenomenon have gradually emerged and been spread, or have taken on new meanings.

This is the case of the concept of sustainability, generally taken to be the preservation of balance in a particular context, irrespective of its dynamic nature – or, more specifically, the use of natural resources in a way that does not jeopardise their renewal. This is also the case of the concept of sustainable development, which may be regarded as a process of change whereby the exploitation of natural resources, the flow of investment, the direction of technological progress and institutional changes result in an alignment of the needs of present and future generations.[2]

There are also other important notions such as the 3R (Reduce - Reuse - Recycle), linked to the concept of circular economy – an economic system focused on preserving the value of resources, minimising waste and encouraging products to remain in the economy even when their lifecycle has come to an end by using them to create added value.[3] In addition, the scope of these issues has gradually broadened, particularly when sustainability is considered in light of three multifaceted dimensions or parameters, referred to as ESG – Environmental, Social and corporate Governance.

A number of initiatives have acted as a catalyst in increasing global awareness of sustainability among the general public and decision makers. One such initiative began in September 2000 during the Millennium Summit of the United Nations with the launch of the Millennium Development Goals (MDGs), which were to be reached by 2015. Targeting developing countries and focusing on a relatively small set of eight categories, the MDGs are usually considered a success story in the fight against poverty, and have been implemented to a considerable extent. The Kyoto Protocol, adopted in December 1997, also within the United Nations, is another important reference in the field of environmental issues. This protocol was particularly relevant as the first significant convention to place climate change at centre stage, establishing goals to reduce greenhouse gas emissions (GHGs).

More recently, the launch of Sustainable Development Goals (SDGs) in September 2015 and the conclusion of the Paris Agreement on climate change in December 2015 have reflected the increased importance of sustainability in the international agenda and contributed to reinforcing its importance. The SDGs, greater in number and more diversified than the MDGs, were adopted by the United Nations as part of its 2030 Agenda for Sustainable Development and established the concept of sustainable development as a multifaceted, universal phenomenon embodied in 17 thematic goals with their own specific targets, and which encompass the three ESG dimensions.

In turn, the Paris Agreement is the most recent milestone in recognising climate change as the item in the sustainability agenda receiving the most attention worldwide and generally as one of the defining global issues of our time. The Agreement focuses on holding the increase in the

1. See, for example, Malthus (1798), *An essay on the principle of population*, or D. H. Meadows, D. L. Meadows, Randers and Behrens (1972) *The limits to growth – A report on the Club of Rome's project on the predicament of mankind*. Although concerns may have subsequently proven to be excessive and/or premature, as in these two examples, the fundamental idea of resource scarcity remains valid. This may, in fact, suggest that human ingenuity can find ways of dealing with this situation, provided there is a commitment to do so.

2. Adapted from the Brundtland Commission (1987), Our Common Future or the Brundtland Report, which was seminal in this area.

3. See, for example, European Commission (December 2015), *Closing the loop - An EU action plan for the Circular Economy*.

global average temperature to well below 2°C as compared to pre-industrial levels. Consequently, its almost 200 signatories are expected to submit "nationally determined contributions", identifying the commitments they have undertaken to reach this goal.

As a whole, the European Union (EU) has committed to reducing greenhouse gas emissions by at least 40% below 1990 levels by 2030, and all Member States will have submitted their own national energy and climate plans in 2019, detailing targets and measures to be achieved by 2030. In the case of Portugal, commitments have been mostly announced for 2030 (a 45% to 55% reduction in greenhouse gas emissions) and 2050 (carbon neutrality, i.e. net zero greenhouse gas emissions by combining gross emissions with GHG capture, mainly through the effect induced by forests).

A key feature of the Paris Agreement is that it places greater emphasis on the financial aspect of climate change. Indeed, it has become clear that reaching these targets will require a large-scale global transformation of how economies and societies work and the mobilisation of sizeable financial resources for decades to come. Naturally, this is difficult to quantify precisely, but, for example, the Organisation for Economic Co-operation and Development (OECD) estimated in October 2017 that global investment in low-carbon energies would have to increase by 29% over the following 15 years compared with 'business as usual'.[4] In the case of the EU, this would mean additional investments in the range of €175 to €290 billion a year (around 1.1 to 1.8% of the EU GDP in 2018) to attain carbon neutrality by 2050.[5]

Transitioning to higher levels of sustainability and a circular economy logic is such a diversified and profound process that it would inevitably depend on the widespread involvement of society. In the response to climate change, in particular, mobilising amounts of such magnitude will also require stronger private sector involvement, particularly on the part of the financial system. We should also bear in mind that financial flows related to this transition provide an investment opportunity with great potential for accelerating technological progress and creating value, and therefore boosting economies and increasing employment.

It is against this backdrop that sustainable finance takes on increased relevance; this may be broadly understood as the economic and financial factors which are in some way related to promoting activities and behaviours considered sustainable from an ESG perspective.[6] By applying the same approach to the environmental field, we arrive at the concept of green finance[7] – which has drawn particular attention due to the importance of climate change, also in this area.

The growing importance of sustainability and sustainable finance for the general public and for decision makers, once again mainly driven by the issue of climate change, has led to the increasing prominence of this subject in the agenda of major international financial authorities and organisations. Among the numerous approaches – and specific initiatives – launched at

4. See OECD (October 2018), *Green finance and investment insights.*

5. See European Commission (November 2018), *A clean planet for all: a European strategic long-term vision for a prosperous, modern, competitive and climate-neutral society.*

6. The definition here is a broad operational interpretation of the concept of 'sustainable finance'. In a stricter sense, sustainable finance may be defined as "the process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities" (European Commission, March 2018: Action Plan: financing sustainable growth). In an even stricter sense, the following are also definitions of sustainable finance: "the channelling of capital flows towards projects with a clearly defined environmental or social benefit" (Danske Bank) or an "investment strategy or financial service integrating environmental, social and governance (ESG) criteria into business and investment decisions, for the lasting benefit of investors and society at large" (Sustainable Finance Initiative).

7. However, the term 'green finance' is sometimes used to cover a social as well as an environmental dimension (in which case it is seen as practically equivalent to the concept of 'sustainable finance').

international level, the following are of particular relevance: the Task Force on Climate-related Financial Disclosures (TCFD), under the FSB, and the *EU Action* Plan: *Financing Sustainable Growth*.

The TCFD, created in December 2015, brought together 31 representatives from several financial sector segments and published the final version of its recommendations in June 2017. These recommendations may be used by organisations from all sectors and aim to promote voluntary climate-related financial disclosures that are consistent, comparable, reliable, clear, and efficient, providing decision-useful information for lenders, insurers and investors.[8] The aim was to increase transparency on how climate-related financial risks are assessed, financially quantified and managed by the entities that have adopted the recommendations (930 organisations in December 2019), allowing most economic agents to make better informed decisions.

As for the EU Action Plan, launched by the European Commission in March 2018,[9] its main goal was to promote an environment conducive to sustainable investment at European level. In this respect, the Plan envisages a set of ten actions implemented at legal and operational levels. They cover aspects such as establishing a classification system (taxonomy) for sustainable activities; creating standards and labels for green financial products; better integrating sustainability in ratings and market research; and clarifying institutional investors' and financial asset managers' duties regarding their clients' preferences on sustainability. More recently, the EU reaffirmed its commitment to this issue by publishing the European Green Deal in December 2019. This initiative, launched by the new European Commission, comprises a vast and diversified set of actions, including the Climate Law, which will serve as a guideline, and the Sustainable Europe Investment Plan, which is expected to deal with issues such as funding sources and the regulatory framework.

At national level, the government initiative to form a think tank on sustainable finance (Grupo de Reflexão para o Financiamento Sustentável – GRFS) in March 2019 was also significant. This think tank aims to encourage an integrated dialogue among leading financial sector players at national level in order to foster and accelerate sustainable investment practices in Portugal.[10] It is made up of high-level and technical representatives from three ministries (Environment, Finance and Economy), the three financial system supervisors (Banco de Portugal, Autoridade de Supervisão de Seguros e Fundos de Pensões (Portuguese Insurance and Pension Funds Supervisory Authority) and the Portuguese Securities Market Commission), four financial sector business associations and ten financial institutions. Coordinated by MAAC, the GRFS has already prepared two documents, published in July 2019, namely the Letter of commitment for sustainable finance in Portugal (signed by all members) and the Guidelines for accelerating sustainable finance in Portugal – both of which received many contributions from the Bank.

8. See TCFD (June 2017), *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures*.

9. See European Commission (March 2018), *Action Plan: financing sustainable growth*.

10. See Grupo de Reflexão para o Financiamento Sustentável (July 2019), *Linhas de orientação para acelerar o financiamento sustentável em Portugal* (in Portuguese only).

2 Role of central banks and supervisory authorities

Given their role as public institutions engaged in society – particularly as authorities with a specific responsibility in safeguarding the stability of the financial system – central banks and supervisory authorities could not remain indifferent to the growing awareness of sustainability and sustainable finance. And they certainly could not shy away from the challenges arising from growing concerns over climate change among the general public and decision makers at global level. This is especially important considering that this issue is generally cross-cutting and broad, which justifies requesting the participation of most institutions, in particular of the financial industry as regards sustainable finance.

This general environment of gradually growing attention to sustainability issues has already had a significant impact on central banks and supervisory authorities, in particular as regards the financial risks posed by climate change to the resilience of financial institutions. Indeed, again this is mostly the case with the climate issue, particularly since the Paris Agreement and in line with growing global concerns over the magnitude of the phenomenon, its potential impact and the transition efforts needed to tackle it.

Taken as a whole, the community of central banks and supervisory authorities has intensified its involvement in these issues in three interconnected ways: first, particularly in certain pioneering central banks, by acknowledging the importance of this matter, and thus incorporating it into internal analysis, debate and decision processes at several levels of their organisational structure; second, in particular for institutions in countries with advanced or emerging economies and open societies, as a result of the appeal and pressure from public opinion or other national authorities; finally, owing to the fact that the issues of sustainability and sustainable finance have an increasingly important role in the agendas of international financial organisations with the participation of central banks and supervisory authorities.

This is the case of the European Central Bank (ECB), which has already acknowledged the far-reaching impact of climate change and is committed to tackling it, in compliance with its mandate. The ECB is thus considering three areas of action: financial stability (having explicitly declared that climate change is a source of financial risk), banking supervision (engaging with banks to raise awareness of these risks and encouraging them to adopt mitigating actions) and monetary policy (currently under analysis, having invested in green bonds under the Asset Purchase Programme, but only as a result of the share of green issuance in the overall amount and constrained by the need to avoid undue market distortions).

This is also the case of the European Banking Authority (EBA), which approved its Work Plan on Sustainable Finance in October 2018, partly in the wake of the EU Action Plan, released by the European Commission a few months earlier. The EBA established a set of priorities, including considerations on how to incorporate ESG parameters into the regulation and supervision of European credit institutions, in addition to responsibilities in monitoring sustainability-related market practices. In December 2019, the EBA published its Action Plan, in which it presents its four mandates (and their relevant calendars) under the EU Action Plan and the revision of the Capital Requirements Directive/Capital Requirements Regulation (CRD/CRR): inclusion of ESG factors in risk management and supervision, prudential treatment of exposures related to this issue, disclosure of relevant information and advice on the adoption of a long-term perspective.

The European Systemic Risk Board (ESRB), the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the OECD have taken on an increasingly active role in their respective areas as players and catalysts for analysis, debate and information on several relevant issues for sustainability and sustainable finance. Lastly, mention should be made of the Central Banks and Supervisors Network for Greening the Financial System (NGFS), established in December 2017 by eight central banks or supervisors from around the world. Voluntarily committed to exchanging experiences and sharing best practices, these institutions are mostly focused on studying and managing environment and climate risk in the financial sector and on mobilising finance to support the transition towards higher levels of sustainability.

This global network has seen a significant expansion and already counted 54 members in December 2019 (including Banco de Portugal, the ECB and 12 other Eurosystem national central banks), as well as 12 observers. In addition to the Plenary, three main substructures were created within the NGFS – workstreams WS1-Microprudential, WS2-Macrofinancial and WS3-Scaling up green finance – which have conducted analytical work on several specific aspects of this issue. The immediate aim of these workstreams is to prepare, by mid-2020, a set of technical documents on managing climate risk from the viewpoint of both authorities and supervised institutions, analysing climate risk based on scenarios, incorporating the ESG criteria into the management of central bank portfolios and analysing the market dynamics of green financial assets.

NGFS published its first comprehensive report (*A call for action: climate change as a source of financial risk*) in April 2019, where it unequivocally acknowledges that climate change represents a source of financial risk and provides six recommendations for central banks, supervisors and other decision makers:

R1 Integrating climate-related risks into financial stability monitoring and micro-supervision;

R2 Integrating sustainability factors into own-portfolio management;

R3 Bridging the data gaps;

R4 Building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing;

R5 Achieving robust and internationally consistent climate and environment-related disclosure;

R6 Supporting the development of a taxonomy of economic activities.

Within the context of the approaches developed by central banks around the issues of sustainability and sustainable finance, two sets of substantive issues should be mentioned, corresponding to the main concerns of central banks regarding this topic, which cuts across several of their functions, with a variable impact according to each institution's specific mandate.

- Identifying and adequately managing different types of risk related to climate change, with a potential impact on financial stability both for the financial system as a whole and for individual institutions. There are also implications for (prudential and conduct) supervisory practices, with further demands in terms of research and data collection/treatment, among others.

  It is also important to mention the increasingly consensual understanding of the types of relevant climate risks, in particular the key distinction between the following categories:

  – Physical risks – Related to more frequent and intense natural disasters (heatwaves, storms, wildfires, etc.) or long-term effects progressively induced by climate change (changes in rainfall patterns, ocean acidification and sea level rise, etc.). In addition to direct human suffering, these risks are related to the loss and/or decrease in the value of assets arising from these natural processes, with a resulting burden for the financial system (first and foremost, for insurers) or second round effects which may be triggered as a consequence of these phenomena.

– **Transition risks** – Related to a process of adjustment to an economic system and a society less dependent on GHGs, specifically risks of a more or less abrupt devaluation of assets (depending on the speed of the transition). This loss of value might be the result of regulatory or tax changes (including limits on greenhouse gas emissions or taxes on GHGs), potential technological obsolescence (possibly partly the result of the abovementioned changes), shifts in consumer preferences (possibly also reflecting increased disclosure of relevant information on the issue) or potential litigation related to different aspects of this transition process. These assets are usually referred to as stranded assets in order to reflect the fact that they would no longer be available (or at least not fully available) for their traditional use with its traditional benefits.

- In turn, the wide diversity of approaches central banks might adopt to **help promote sustainability and sustainable finance** – i.e. a gradual transition of the financial system and economic fabric towards higher levels of sustainability, while safeguarding the soundness of the financial system (and consequently financial stability) to address these challenges. Depending on the restrictions imposed by their mandates, central banks are focused on:
  – Raising awareness of financial institutions towards incorporating ESG parameters into their activities;
  – Intervening in micro and macro-prudential regulation, in line with the preservation of a risk-based regulatory framework;
  – Intervening in markets for sustainable financial instruments;
  – Monitoring developments in these markets (and disclosing information thereof);
  – Governance and remuneration policies of supervised institutions (aiming, *inter alia*, at strengthening long-term vision and management policies);
  – Adopting ESG principles when managing their own central bank asset portfolios (thereby following the principle of 'leading by example');
  – Incorporating sustainable practices into their functioning as a corporation, striving to reduce their ecological footprint (also 'leading by example').

3 Current state of play at Banco de Portugal

As most central banks and supervisory authorities, Banco de Portugal has also been challenged by the issue of sustainability and sustainable finance at different levels concerning its responsibilities. In the context of the Bank, this topic has been approached mostly in the following dimensions:

- implications for financial stability;
- prudential supervision of the banking system;
- macro and microeconomic analysis, so as to better support economic policy guidelines;
- management of the Bank's financial assets portfolio;
- the Bank's standing as a corporation that also has an ecological footprint.

Framed by these areas of activity, the Bank can objectively assess its standing with respect to sustainability and sustainable finance by identifying several relevant references, both internally and in its interaction with other national and international entities. It is therefore important to highlight the following:

- An area that provides a level of freedom suited to the Bank's mission is that of research on the micro and macroeconomic impact of climate change and economic and financial policies that can mitigate its adverse effects. An essential component of this effort is to identify the appropriate markets, tools and policy makers for each of the problems highlighted. In particular, given the possible means of mitigating climate externalities resulting from economic activity (e.g. environmental regulation, specific taxation or disincentives via the financial system from a risk perspective), identifying those that are most effective and have the potential for less distortion in the financial system and in the economy is a priority.
- To build up knowledge on climate change, it is also essential to identify the channels of transmission (and intensity) of the risks posed by climate change to the economy and, in particular, to the financial system. It is also important to identify and develop ways in which the Bank can make a contribution towards the expansion of sustainable financing (always in line with its mandate and under European prudential standards). With these key objectives in mind, Banco de Portugal has participated in various structures and working groups at national, European and global level.
  - On a global level, the Bank joined the NGFS in December 2018, and was therefore in a position to contribute to the first comprehensive report drawn up by the network. Released in April 2019, the report identifies six recommendations for adoption by its members or other relevant entities, as already mentioned. Banco de Portugal actively participates in the aforementioned three NGFS workstreams, as well as in the activities of its substructures established in the meantime for more specific purposes.

    This is the case of a joint subgroup between WS1 and WS2, whose mandate is to draw up one of the best practice guides for assessing climate and environmental risk that are part of the NGFS work plan for 2019/20. In this case, the Handbook for supervisors on climate and environmental risk assessment, followed by the repository of best practices recommended to supervised entities. The supervisors' handbook, seeking to operationalise some of the recommendations published in the network's report, is to be released in April 2020 and aims to facilitate the development of methodologies and tools for climate and environmental risk assessment, as well as their harmonised implementation.

    WS3 had been working on the development of another handbook foreseen in the NGFS programme of activities – in this case a handbook on the incorporation of sustainability criteria in the management of central banks' portfolios – which was released on 18 October 2019. Banco de Portugal contributed to activities such as a survey of the members of the network. Also in the context of the WS3, the Bank is cooperating in the other two lines of action selected for development up to 2020, in particular with regard to the dynamics of sustainable asset markets and the ways in which monetary policy can be affected by climate change factors.
  - Also at global level and at the invitation of the Ministry of Environment and Climate Action, the Bank integrated the Portuguese delegation that took part in the annual meetings of the Financial Centres for Sustainability Network (FC4S) in October 2019. This organisation was established in September 2017 and acts as a partnership for several

international financial centres from cities around the world,[11] and the United Nations Environment Program – UNEP. Lisbon has recently joined this network, through the Ministry, as promoter of the GRFS think tank, and is confident that it will become a useful vehicle for sharing experiences and promoting initiatives in this area, including among market participants.

- At European level, Banco de Portugal is a member of the NCA Climate Risk Contact Group, established under the ECB, whose mandate is to ensure coordination and cooperation among the various supervisory authorities of the Single Supervisory Mechanism on climate-risk related initiatives. It promotes information exchange and the adoption of an analytical framework, in addition to measures for mitigating these risks (including supervisory expectations), on a harmonised basis for the euro area.

  To date, the work of the ECB on these issues has focused on assessing how prepared the banking sector is to mitigate these risks, particularly through active dialogue with supervised institutions that facilitates the collection of information and awareness of these matters. The ECB, together with the national competent authorities and in liaison with the EBA and the NGFS, is expected to develop further work to set supervisory expectations for institutions (covering governance, risk management, scenario analysis and disclosure of relevant information, among others) and to consider ways of incorporating climate risks into the banking supervisory process.

  In this respect, the SSM risk map for 2019 and 2020, which sets out the main risks for the banking system over a two to three-year horizon, already mentions climate risks.[12] In this context, it will be important to develop and articulate Banco de Portugal's internal perspective on topics under development at ECB level.

- In Europe, the Bank is also represented in the EBA's Network on Sustainable Finance, which will implement the four mandates received by the EBA regarding sustainable finance, as defined in the revision of the CRD/CRR and in the EU Action Plan: (i) ESG factors in risk management and supervision, (ii) prudential treatment of exposures, (iii) disclosures and (iv) advice on long termism. In compliance with the latter mandate, as foreseen in Action 10 of this Plan, the EBA published a *Report on undue short-term pressure from the financial sector on corporations* in December 2019.

  Given the intense work involved in the response to these mandates and the fact that they are extended over a relatively long period of time – from 2019 to 2025 – the EBA considered it important to proceed with the publication of an Action Plan for financial institutions — which was achieved in December 2019 as outlined above. The Plan aims to promote awareness of the incorporation of sustainability into their activities – rather than waiting for work to be finalised, particularly work related to the mandate provided for in Article 98(8) of the new CRD. According to the latter, the EBA should assess the potential inclusion of ESG risks in the review and evaluation performed by the competent authorities (i.e. SREP) and submit a respective report by 28 June 2021. At the same time, EBA's intention with this Action Plan is to communicate its priorities and work plan on sustainable finance (including timelines and focus areas) and to anchor any communication that National Competent Authorities (NCAs) wish to issue on the subject.

11. In October 2019, there were 30 financial centres involved (including New York, London, Paris, Frankfurt, Luxembourg, Madrid, Barcelona, Zurich, Tokyo, Beijing, Shanghai, Shenzhen and Hong Kong).

12. www.bankingsupervision.europa.eu/ecb/pub/pdf/ra/ssm.ra2019.en.pdf.

– Additionally, at European level, the Bank has been following the negotiation of European legislative initiatives in this area (notably under the *Action Plan: Financing Sustainable Growth*), providing several contributions to support the Ministry of Finance and other national representatives.
– In Portugal, the Bank is actively participating in the above-mentioned GRFS think tank on sustainable finance, coordinated by the MAAC. Among other efforts, the Bank contributed extensively to the two documents already produced by the think tank: the *Letter of commitment for sustainable finance in Portugal* and the *Guidelines for accelerating sustainable finance in Portugal*.
When the Governor signed the Letter of Commitment in July 2019, the Bank made a commitment to cooperate, within the scope of its responsibilities, in the analysis of the role of the financial system in identifying and managing environmental risks, in financing and investing in green and low-carbon projects, in a broader context of sustainable development and in accordance with European regulation and supervision.[13]

In terms of identifying and addressing the risks posed by climate change to the financial system, the Bank also incorporated sustainable finance in the *Financial Stability Report* released in June 2019 (Box 2 "Risks to financial stability resulting from climate change").

• Specifically, in terms of management of own investment assets, 2019 represented a turning point for the Bank, with the incorporation of sustainability principles into asset management joining the limited set of priorities outlined for that year. In addition to the references already made in the context of participation in the NGFS, this objective has also resulted in a number of specific activities:
  – Active participation in the research and work of the Eurosystem: the Bank joined the Sustainable and Responsible Investment Task Force (SURI TF), which drew up a report for the Governing Council of the ECB within its mandate.
  – ESG market analysis: the Bank carried out an early qualitative and quantitative analysis of the ESG market, in particular of green bonds.
  – Participation in the Advisory Committee that outlined the key features of the first BIS green bond fund and contribution to the BIS Survey on Reserve Management and Sustainability. In September 2019, the Bank invested in units of this fund, a project of which the Bank was a founding member and which was disclosed to the general public.
  – Allocation of the Bank's financial resources may be a complementary tool in the internal implementation of the ESG principles. Therefore, principles of this nature have been incorporated into the guidelines for the management of the Bank's own investment assets.
• Sustainability challenges also apply to the Bank as a corporation, in particular with a view to reducing its own ecological footprint and thereby signalling, by example, the importance it attaches to these issues. In this regard the following are noteworthy:
  – In June 2019, the Bank launched a project to define a strategy for its sustainable development as an organisation. This project involves a systematic survey of the Bank's practices, consulting the main stakeholders in order to identify expectations, benchmarking exercises and drafting its first internal sustainability report.
  This first sustainability report will be an internal information document for the Bank's management, but should become public in the future, providing an account of the Bank's actions in the area of sustainability. The exercise now launched will make it possible to organise and structure a set of sustainable activities and conducts that are already being implemented

13. See Grupo de Reflexão para o Financiamento Sustentável (July 2019), *Letter of commitment for sustainable finance in Portugal*.

by the Bank and to assess them in light of the best practices of counterpart institutions and expectations of the Bank's stakeholders.

- The Bank as a corporation has a commitment to continuously improve its approach to environmental issues, geared towards an **efficient and responsible use of resources**. Therefore, a set of measures is already in place to reduce its ecological footprint with the aim of ensuring lower consumption of plastic, more efficient waste management and lower paper consumption.
  In its renovation projects for buildings/office areas, the Bank has been concerned with replacing fossil fuel heating systems with energy-efficient electrical systems.

  The electricity consumed by the Bank, with the exception of the regional delegations, is to come entirely from renewable sources. The transition to this new form of energy consumption should be completed during the first quarter of 2020.

- With a view to sharing information and knowledge on this area, as well as environmental policies and practices, the Bank has been involved in the working group **Environmental Network of Central Banks (ENCB)**, with the ECB and several national central banks, since 2016.

Table 1 • Sustainability practices – international comparisons

	Has a report on sustainability?	Is a member of NGFS?	Adopts TCFD Recommendations?	Is committed to SRI[(a)]?	Discloses research on sustainability?
Banco de Portugal	Partially or under development	Yes	No	Partially or under development	Partially or under development
Deutsche Bundesbank	Yes	Yes	No	No	No
Banque de France	Partially or under development	Yes	No	Yes	Yes
Banca D'Italia	Yes	Yes	No	Partially or under development	No
Banco de España	Partially or under development	Yes	No	Partially or under development	No
De Nederlandsche Bank	Partially or under development	Yes	Yes	Yes	Yes
Nationale Bank van België/Banque Nationale de Belgique	No	Yes	Yes	No	Yes
Bank of Greece	No	Yes	No	No	Yes
Bank of England	Partially or under development	Yes	No	No	Yes
Sveriges Riksbank	No	Yes	No	No	Yes
Federal Reserve (US)	Partially or under development	No	No	No	Yes
Bank of Japan	No	Yes	No	No	No
People's Bank of China	No	Yes	No	No	Yes
Monetary Authority of Singapore	No	Yes	Yes	No	No

✓ Yes ✗ No ✓ Partially or under development

Source: Banco de Portugal, from public documents of the institutions included, as at 5 January 2020. | Notes: NGFS - Central Banks and Supervisors Network for Greening the Financial System; TCFD - Task Force on Climate-related Financial Disclosures (of the Financial Stability Board); (a) SRI: Sustainable and Responsible Investment – application of ESG principles to asset management.

4 Focus areas

Banco de Portugal is committed to stepping up its engagement with sustainability and sustainable finance, in particular those issues focusing on the impact of climate change. Thus, it acknowledges the importance of also contributing to the overall efforts in Portugal, Europe, in Portuguese-speaking countries and throughout the world to promote a smooth transition to higher levels of sustainability.

The Bank has already taken significant steps in this direction, as expressed in the previous Chapter. It now aims to structure and adopt an integrated approach to this end – broadening, deepening and refining the activities that have been developed so far. In this context, a number of different initiatives will be put forward – both solely by the Bank and in close liaison with other national and international bodies. Incorporating the dimensions already considered relevant and operationally useful for a more efficient framing of the efforts to be undertaken, this integrated approach is built on four priority areas:

E1 Risk identification and assessment. This area mainly covers issues which are critical for the Bank's positioning in relation to sustainability and sustainable finance, falling within the scope of economic research, financial stability and banking regulation/supervision. It involves acting in areas that are associated with critical components within the mandate of Banco de Portugal, notably the obligation to ensure the stability of the Portuguese financial system, to carry out the supervision of credit institutions, or other institutions that are subject to it by law, and to provide economic and financial advice to the Government, in line with its responsibilities. The actions will involve developing research, tools and procedures, as well as promoting awareness and disseminating relevant information, among other aspects;

E2 Internal sustainability practices. This area covers both the management of financial assets and aspects of the Bank's conduct as a corporation. Regarding the former, the asset management rules followed by the Bank will incorporate a component that builds on best practice in compliance with the sustainability principles – while also setting out objectives and metrics for monitoring them. Regarding the latter, the Bank as a corporation is defining a sustainability strategy, together with a number of elements geared towards reducing its ecological footprint. In both cases, Banco de Portugal is particularly focused on leading by example and on projecting a positive image, always in line with its risk management principles;

E3 National and international intervention. While the other areas will inevitably be embedded in a strong national and international framework, the aim of considering this topic as a separate strand is to reflect the importance of fostering the harmonisation and coordination of efforts outside the Bank, which is particularly significant for sustainability. Through its participation in external working groups, the Bank will leverage its actions in this field, by gaining easier access to relevant information, by being involved early on in the discussion of measures with a potential impact on the financial system, and also by contributing to national and international efforts in these areas;

E4 Communication and cooperation. This area incorporates varied and cross-cutting elements, which share an emphasis on the relevance of networking and cooperating, both within and outside the Bank – given their usefulness for the Bank to handle sustainability issues more efficiently.

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