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Subject: Establishing supervisory expectations on the identification and management of climate and environmental risks for the less significant institutions

Dear Sir/Madam,

Climate and environmental risks are increasingly important to banking activity. Given that their characteristics are distinct from the traditional risk factors to which the banking system is exposed, due to the uncertainty and the time horizon in which they may materialise, these risks require particular attention from the banking system.

Considering the Portuguese and European sustainability commitments and objectives,¹ the main concern of financial regulators and supervisors is to safeguard the robustness of the banking system to address the challenges in this area by ensuring an orderly transition to a low-carbon economy, without hampering the continued provision of financial services which are essential to the economy. On the other hand, the direct impacts on economic agents of extreme weather events are increasingly visible, requiring the related risks facing the banking system to be addressed.

The “Guide on climate-related and environmental risks” of the European Central Bank (ECB) (“Guide”), published on 27 November 2020, developed in collaboration with other national competent authorities, including the Banco de Portugal, sets out supervisory expectations for significant credit institutions in the

¹ European Commission (March 2018), “Action Plan: financing sustainable growth”; Proposal for the European Climate Law: https://ec.europa.eu/clima/policies/eu-climate-action/law_en.

following areas: (i) business models and strategy, (ii) internal governance policies, (iii) risk management policies, and (iv) related and relevant disclosures.

These supervisory expectations entered into force with the publication of the Guide and, based on proportionality criteria and depending on the materiality of the climate and environmental risks to which supervised institutions are or might be exposed, such institutions are expected to progressively adapt to ensure an adequate management of these risks. The expectations are anchored in the current regulatory framework,² which provides for material risks to be managed prudently and proportionately. These expectations can be found on the ECB's website.³

In order to ensure a consistent and balanced treatment among supervised entities, the Banco de Portugal considers that the supervisory expectations for climate and environmental risk management disclosed by the ECB should apply to the less significant credit institutions under the Banco de Portugal's direct supervision. This extension of the Guide's scope on climate and environmental risks takes into account the recommendation by the ECB that national competent authorities of the Single Supervisory Mechanism should adopt such recommendations for less significant credit institutions. This decision also considered the Communication of the European Banking Authority (EBA) of December 2019 ("EBA Action plan on sustainable finance"),⁴ which outlines the EBA's work plan until 2025 on climate and environmental risks and recommends that credit institutions act proactively in incorporating such risks into their risk management policies and in developing their business strategy, notwithstanding the regulatory framework still being under development.

In particular, the Banco de Portugal considers it essential to ensure that less significant credit institutions make an effort to adapt and show progress in identifying, measuring and mitigating climate and environmental risks, in a manner proportionate to the nature, scale and complexity of their activities and the related risks to which they are exposed.

In order to give the institutions a transitional period, the supervisory dialogue will integrate these matters from the second quarter of 2022 onwards.

² CRD IV - Capital Requirements Directive IV (Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013); CRR - Capital Requirements Regulation (Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013).

³ <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf>.

⁴ <https://eba.europa.eu/eba-pushes-early-action-sustainable-finance>.

The Banco de Portugal highlights the importance of the institutions covered by this Circular Letter to comply adequately with the guidelines set out in the ECB document, which must be respected and implemented in the context of the laws and regulations in force and, in particular, in addition to the provisions contained in the Legal Framework of Credit Institutions and Financial Companies concerning the management of the material risks to which the institutions are or might be exposed.

Yours faithfully,

Banco de Portugal

Per pro