



# Climate-related Risks: Supervision Progress and Challenges

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**CMF Chile - 1st Climate-Related Financial Risk Conference**

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Regulator



Green Protocol  
Voluntary  
guidelines first  
adopted by five  
state-owned banks

2008

Resolution 3,545  
Mandatory environmental  
compliance for accessing  
rural credit in Brazilian  
Amazon Rainforest Area

2010

Resolution 3,896  
Rural Credit –  
Low Carbon  
Agriculture/  
Agribusiness

2014

Resolution 4,327  
BCB's Policy for  
Socio-environmental  
Responsibility  
(PRSA)

2015

Supervision  
Monitoring the  
drought  
effects and its  
impacts on SFN

2017

CMN Resolution  
Risk Management  
A + S

2019

Supervision  
Monitoring the  
Brumadinho  
Event's effects and  
its impacts on SFN

2020



Other participants  
joined later

1995

Market entities

2014

Febraban  
Socio-environmental  
Risk Policy (SARB14)  
Self-regulation framework

2016

Green Bonds Guide  
Released by Febraban  
and the 'Brazilian  
Business Council for  
Sustainable  
Development' (CEBDS)

First issuance of  
Green Bonds

2018

Guidelines for  
voluntary  
implementation  
of TCDF/FSB  
Released by  
Febraban and  
Sitawi



# BC# Sustainability

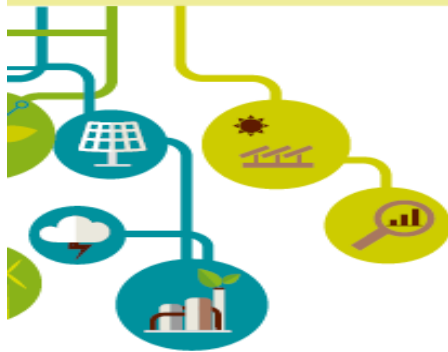
- Strategic and dynamic agenda for socio-environmental sustainability
- Promoting sustainable finance
- Incorporating sustainability variables in the BCB decision-making process
- **Assuring proper management of social, environmental and climate-related risks within the National Financial System**



# NGFS



**8** central banks  
and supervisors  
established the Network  
of Central Banks and Supervisors  
for Greening the Financial System.



As of end March 2022, the NGFS consists of

**114** Members **18** Observers

representing 5 continents.



# The NGFS and Supervisors

- Work conducted within **five workstreams**
- **Workstream on microprudential and supervision (WS1)**
- Workstream on macrofinancial (WS2)
- Workstream on scaling up green finance (WS3)
- Workstream on bridging the data gaps
- Workstream on research
- Work programme 2022-2024 being discussed

*“The objective of WS1 is to keep track of supervisory and micro-prudential practices within the financial industry, to identify leading practices and issue guidance for supervisors on how to incorporate climate and environmental risk within their supervisory framework. It also aims to undertake relevant studies for supervisors, including to assess the existence of a systematic risk differential between ‘green’ and other assets.”*

# NGFS reports on supervision



May 2020

October  
2021

May 2020

September  
2020

# The NGFS Guide for Supervisors

- Published in **May 2020**
- Based on **NGFS supervisors' practices**
- Addressed at members of the NGFS as well as the broader community of **banking** and **insurance supervisors**
- Covers **climate-related** and **environmental risks**
- Issues **five recommendations** (non-binding)
- Features **case studies** of good practices

1.



Supervisors are recommended to **determine how climate-related and environmental risks transmit** to the economies and financial sectors in their jurisdictions and **identify** how these risks are likely to be material for the supervised entities.

2.



Develop a clear **strategy**, establish an **internal organisation** and allocate adequate **resources** to address climate-related and environmental risks.

3.



**Identify the exposures** of supervised entities that are vulnerable to climate-related and environmental risks and **assess the potential losses** should these risks materialise.

4.



**Set supervisory expectations** to create **transparency** for financial institutions regarding the supervisors' understanding of a prudent approach to climate-related and environmental risks.

5.



**Ensure adequate management** of climate-related and environmental risks by financial institutions and **take mitigating action** where appropriate.

# The Progress Report on the Guide

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## Objectives:

- Assess the **progress made by NGFS supervisors**, using the **five recommendations of the Guide as a reference**
- Identify **common challenges** faced by supervisors
- Provide **updated and granular guidance** supported by **case studies**
- Provide a deeper dive into a few areas, especially **environmental risks** and **disclosure**

## Based on responses to two questionnaires:

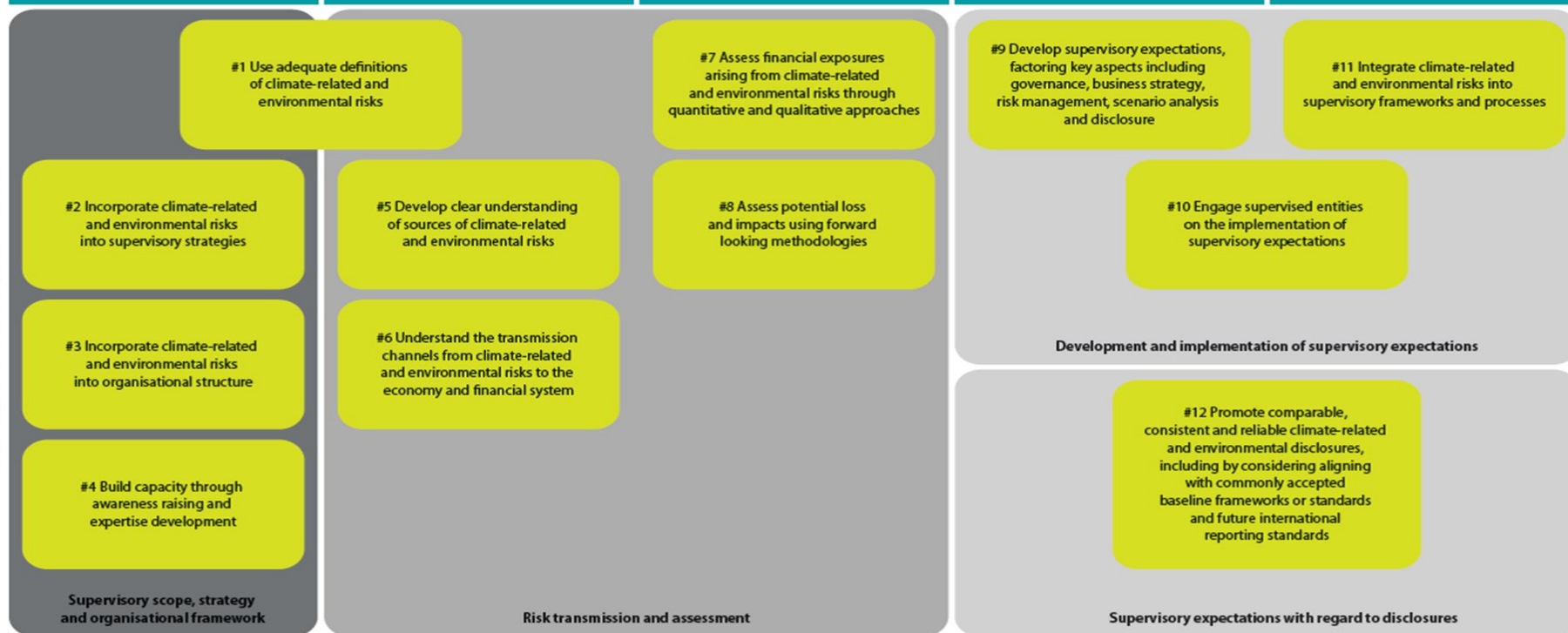
- Disclosures (Q4 2020) – 38 responses
- Recommendations (Q1 2021) – 50 responses, **70% of NGFS supervisors**

# Structure

RECOMMENDATIONS

Recommendation 2	Recommendation 1	Recommendation 3	Recommendation 4	Recommendation 5
Develop a clear strategy, establish an internal organisation and allocate adequate resources to address climate-related and environmental risks	Determine how climate-related and environmental risks transmit to the economies and financial sectors in their jurisdictions and identify how these risks are likely to be material for the supervised entities	Identify the exposures of supervised entities that are vulnerable to climate-related and environmental risks and assess the potential losses should these risks materialise	Set supervisory expectations to create transparency for financial institutions in relation to the supervisors' understanding of a prudent approach to climate-related and environmental risks	Ensure adequate management of climate-related and environmental risks by financial institutions and take mitigating action where appropriate

FOCUS AREAS WITH PRACTICAL GUIDANCE AND CASE STUDIES



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1

Determine how climate-related and environmental risks **transmit** to the economies and financial sectors in their jurisdictions and identify the risks that are likely to be **material** for the supervised entities

## Climate-related risks

**Financial risks** posed by the exposure of financial institutions to **physical** or **transition** risks caused by or related to climate change.





## **Physical risks**

Economic costs and financial losses resulting from the increasing severity and frequency of extreme climate change-related weather events, as well as longer-term progressive shifts in the climate.





## Transition risks

Financial risks which can result from the **process of adjustment** towards a lower-carbon and more circular economy, prompted by changes in climate and environmental **policy, technology or market sentiment.**



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## Environmental risks

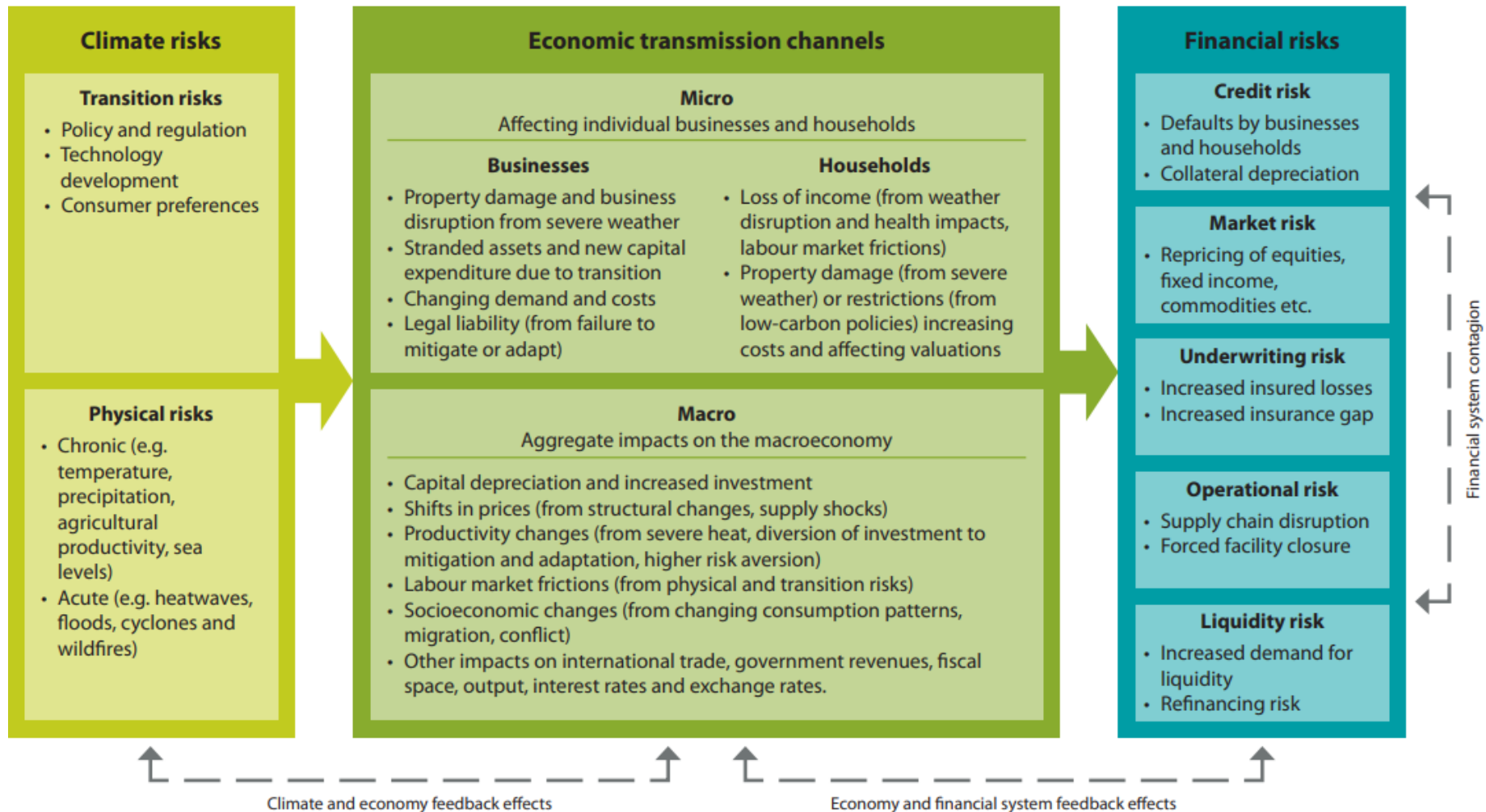
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Financial risks posed by the exposure of financial institutions and/or the financial sector to activities that may potentially cause or be affected by **environmental degradation** and the loss of **ecosystem services**.

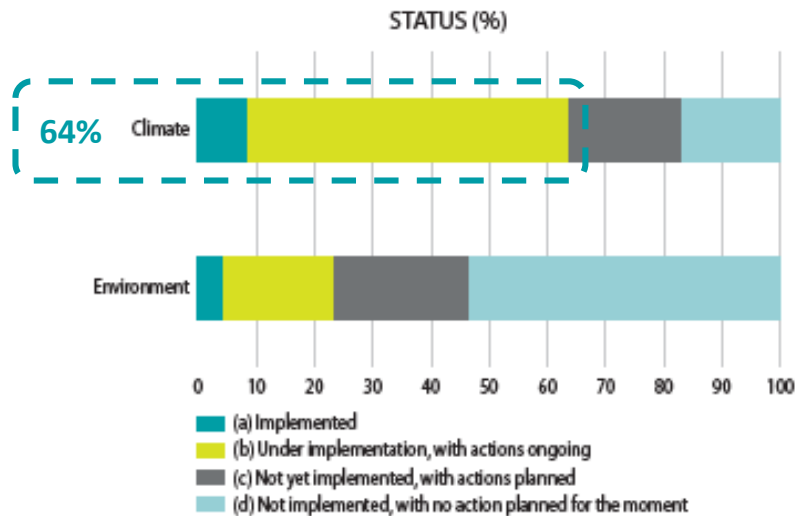


# Transmission channels

## Transmission channels Climate risks to financial risks



# Recommendation 1 – Status and Challenges



## Main challenges

Data gaps

Lack of harmonised methodologies, indicators and metrics

# Recommendation 1 – Key takeaways

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Using adequate definitions and categories of climate-related and environmental risks helps address them.

A multi-disciplinary approach is useful to leverage the required expertise, as know-how is not always available in-house.

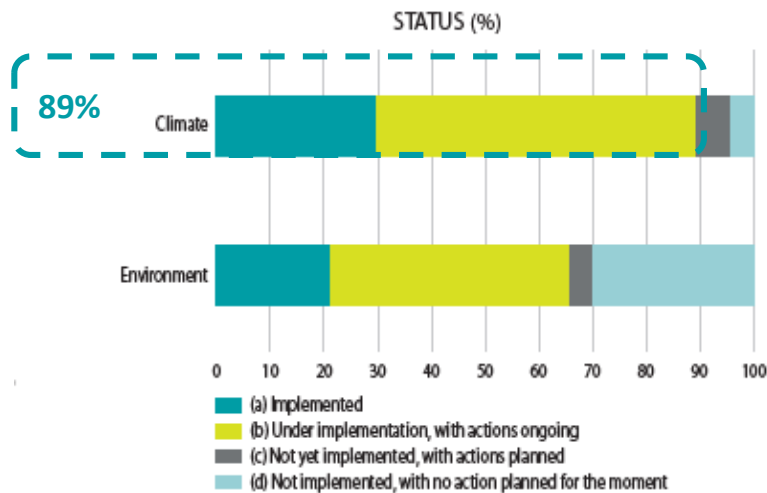
Understanding of environmental risks is still at a nascent stage, but some knowledge is available

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Develop a clear **strategy**, establish an **internal organisation** and allocate **adequate resources** to address climate-related and environmental risks

2

# Recommendation 2 – Status and Challenges



## Main challenges

**Lack of internal capacity and resources**

**Need for coordination**

**Lack of globally agreed standards or guidelines**

# Recommendation 2 – Key takeaways

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Prudential and/or financial stability mandates allow for incorporating climate-related and environmental risks into supervisory strategies.

Supervisors have various possibilities to embed these risk into their organisation, with a few common success factors

Capacity building and awareness raising are key issues, which may be addressed in different ways.

**The Sustainable Banking Network:** technical assistance and capacity building programs to help members develop and implement national sustainable/climate finance policies and provides a framework to help members assess their progress in comparison with peers.

**The NGFS, the FSI and the Climate Training Alliance** aim to enhance the availability of training resources for authorities responding to climate-related and environmental risks.

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3

Identify the **exposures** of supervised entities that are vulnerable to climate-related and environmental risks and assess the **potential losses** should these risks materialise

## Conducting a climate-related and environmental risk assessment

### I. Preparation phase

- a. Set-up a project organisation consisting of a core project team, a steering group, and a broad network of different specialists
- b. Develop a project plan
- c. Set-up interviews with financial institutions, environmental specialist, scientists and other experts
- d. Develop a qualitative survey for financial institutions
- e. Develop a quantitative data request (template covering physical and transition risks)
- f. Determine which climate-related and environmental risks are material in their jurisdiction
- g. Determine how these risks are transmitted through the economy to the financial sector

### II. Analytical phase

- a. Assess quantitative and qualitative information
- b. Determine the climate-related and environmental exposures in the financial sector in terms of *financial risks* (credit risk, operational risk, market risk, etc.)

- c. Develop a few extreme but plausible scenarios or set up vulnerability assessments of exposures to the risks
- d. Conduct a stress test or a sensitivity test to estimate the potential magnitude of the risks, and determine losses and impact on prudential ratios and/or other risk indicators

### III. Concluding phase

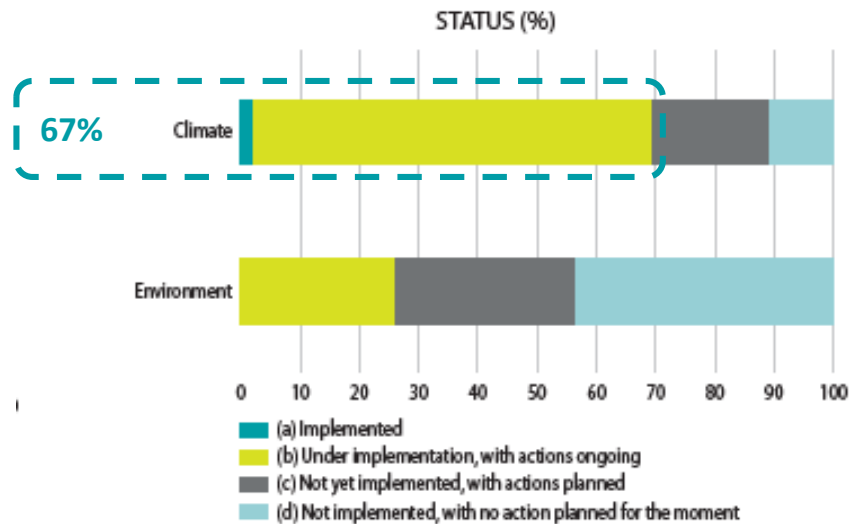
- a. Develop a story line (main findings and conclusions), supported by quantitative and qualitative data and pictures
- b. Determine a supervisory response to the findings of the assessment, including recommendations for supervision, policymakers and financial institutions
- c. Publish a report and organise media events and outreach workshops to share results with internal and external stakeholders
- d. Set the key risk indicators that will help monitor the climate-related and environmental risks



# NGFS

Central Banks and Supervisors  
Network for Greening the Financial System

# Recommendation 3 – Status and Challenges



## Main challenges

**Data gaps** including insufficient disclosures

**Specific methodological challenges** to assess potential losses of climate-related and environmental risks

# Recommendation 3 – Key takeaways

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Progress is hampered by the limited availability and granularity of data.

Supervisors may consider using a combination of qualitative and quantitative tools for risk assessment.

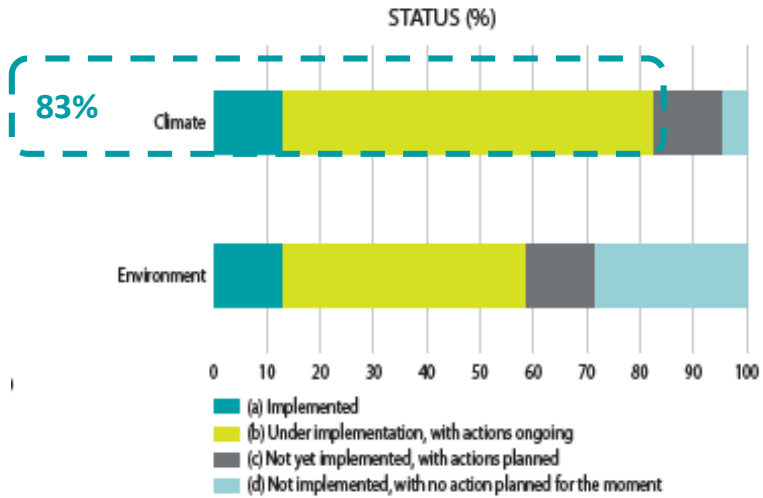
The features of climate-related and environmental risks call for developing and using forward-looking methods such as scenario analysis.

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Set **supervisory expectations** to create transparency for financial institutions in relation to the supervisors' understanding of a **prudent approach** to climate-related and environmental risks

4

# Recommendation 4 – Status and Challenges



## Main challenges

**Lack of globally agreed standards or guidelines**

# Recommendation 4 – Key takeaways

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**Supervisory expectations vary in granularity but tend to converge as to the topics they cover**

**When developing their expectations supervisors have often:**

- Engaged with external stakeholders
- Considered proportionality
- Considered how this relate to the existing prudential framework

**Developing supervisory assessment programmes with an adequate level of granularity is useful in promoting adequate risk management**

# 'Key considerations' on disclosures

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- 1) **Adoption of commonly accepted frameworks or standards**, by considering ensuring consistency or interoperability
- 2) **Reflecting a materiality perspective**
- 3) **Promoting the development of a set of core, calculable and widely applicable metrics**, to be potentially considered in Pillar 3 baseline in the future
- 4) **Adopting a pragmatic step-wise approach**, considering capacity, data availability and progress around measurement methodologies
- 5) **Taking steps to ensure reliability**

## Main challenges

**Fragmentation of disclosures standards**

**Application of different materiality lenses**

**Gaps in data availability**

**Less developed frameworks for other environmental risks**

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5

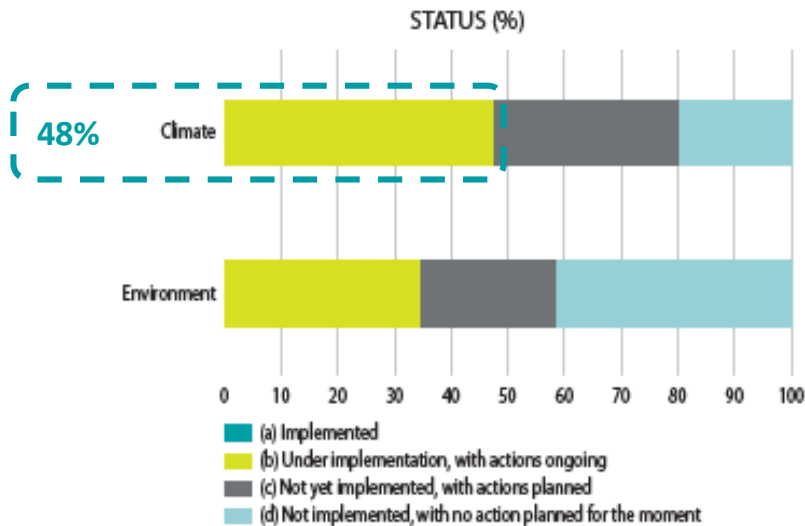
Ensure **adequate management** of climate-related and environmental risks by financial institutions and take **mitigating action** where appropriate



## Supervisory Measures

- Discuss findings with board members
- Determine board follow-up
- Require strengthened risks management and internal controls
- Instruct firms to integrate climate-related risks into their ICAAP
- Require firms to reduce the level of risk
- Limit the distribution of profits

# Recommendation 5 – Status and Challenges



## Main challenges

**Lack of globally agreed standards or guidelines**

**Lack of harmonised methodologies, indicators and metrics**

**Data gaps**

**Lack of evidence of risk differentials**

# Recommendations 5 – Key takeaways

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International standard-setting bodies have been conducting further work to integrate climate-related risk into the supervisory framework and explaining how existing principles may apply in the context of climate change.

Supervisors have made limited progress in integrating these risks into binding supervisory tools, especially quantitative ones.

- **Pillar 1 – Minimum capital & liquidity requirements**
- **Pillar 2 – Supervisory review process**
- **Pillar 3 – Disclosures**



## Presentation by Carine Bastos

Based on:

- [The NGFS Guide for supervisors - Integrating climate-related and environmental risks in prudential supervision](#)
- [The NGFS Progress Report on the Guide for supervisors](#)

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