



BANCO DE PORTUGAL
EUROSISTEMA

In Conversation with

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1. When and why did your institution join the NGFS?

The Banco de Portugal joined the NGFS on 11 December, 2018 – about one year after it had been launched by its eight founding members. As for why we joined our peers from all over the world in this endeavour, it comes down to a simple fact: we acknowledged that the journey towards a low-carbon economy and, more broadly, towards higher levels of ESG sustainability is one of those, very few, make-or-break issues that are shaping our times and will shape our common future for decades to come. The Banco de Portugal, as part of the Portuguese, European and global communities – but, above all, in its role as a public authority with a diversified set of responsibilities – could not simply stand aside.

I am actually quite fond of something very accurately put by a few eminent people, on this issue, a couple of years ago¹: “the primary responsibility for managing the transition to a low carbon economy rests with the elected governments. However, if it is true that climate change is indeed “the greatest and widest ranging market failure ever seen”, a smooth low-carbon transition will require the implementation of a comprehensive set of policies, some of which might involve the collaboration of central banks and financial regulators.” I would only add that the implementation of policies like these is indeed very hard to conceive without a significant involvement and collaboration of central banks and financial regulators.

In fact, at the root of the sustainability issues and the pressing need to address them is, in all likelihood, the largest global mispricing phenomenon in living memory, to the extent that its negative externalities, stemming from the impact of multiple activities, have not yet been correctly incorporated into the prices of products and services charged by the various economic agents. This means all those who

¹ Campiglio, E. et al (2018), “Climate change challenges for central banks and financial regulators”, in *Perspective, Nature Climate Change*, Vol 8, June 2018, pp. 462-468.

carry out such activities, those who incorporate them as intermediate products or services, and those who act as final consumers, but also those who fund such activities.

If we believe that this is the main problem, then its solution must entail the adjustment of relative prices, which means making some prices more expensive against others. Clearly, such matters fall mostly within the remit of whoever makes economic and tax-related choices. Nevertheless, in this path of adjustments to the prices of products and services, there is surely a major role to be played also by the financial sector. And, therefore, by the supervisors and regulators both of the financial sector, in general, and of the banking sector, in particular – acting in line with their mandates.

Although we are still at what can be considered as an initial stage of involvement with the NGFS, there is no doubt of how relevant such involvement has become. At the end of 2018, when the Bank became a member, we were already 25 central banks and financial supervisors working together, alongside 4 observers. Today, by late September 2020, total membership adds up to 72 institutions and 13 observers. This is a truly amazing pace of expansion, which speaks volumes of how relevant ESG factors and climate change have become for financial systems, in general, and the global community of central banks and financial supervisors, in particular.

2. Can you share with us the key elements of the Banco de Portugal's climate strategy and how it fits into the broader national strategy in your jurisdiction?

Beginning with the second part of your question, when the Banco de Portugal started to engage more forcefully with sustainability and sustainable finance issues – a couple of years ago – we decided that it would be necessary to get involved in the ongoing or planned national efforts in this field. Apart from some outreach initiatives put forward in partnership with national players of key relevance to the energy transition, the Banco de Portugal thus joined the Government, the two other financial supervisors – for markets and the insurance sector – a few financial industry representatives and several financial institutions in creating a think tank focused on promoting sustainable finance in Portugal. Functioning in both high-level and technical compositions, this new body has been instrumental in advancing awareness of the issues and launching several initiatives, notably a masterplan and a Letter of Commitment undersigned by all participants.

Our own internal efforts at the Banco de Portugal have matured into a cross-cutting strategy, encompassing all the different dimensions of the Bank's activities which are meaningfully challenged by ESG issues. Released last March, "Banco de Portugal's Commitment to Sustainability and Sustainable Financing"² frames the Bank's response to such sustainability challenges – with a special focus on those arising from climate change– and sets out action plans in four key areas:

- the identification and assessment of climate-related risks;
- the adoption of internal sustainability practices;
- participation in national and international fora;
- communication and collaboration with other entities.

Going into more detail in each of these action plans: first, we have integrated the **identification and assessment of climate-related risks** into our research agenda, and a number of research projects are

² <https://www.bportugal.pt/en/comunicado/banco-de-portugal-publishes-commitment-sustainability-and-sustainable-finance>

being implemented. In this context, I would like to highlight two studies, which are being completed and we hope to release soon:

- The first study seeks to assess the Portuguese banking system's exposures to non-financial corporations in relevant sectors from the standpoint of climate change, with the aim of identifying the banking sector's vulnerabilities to the transition towards a low-carbon economy. We believe that it is critical to be well aware of the risks already present in the balance sheets of financial institutions, in view of their exposure to the sectors most likely to be severely impacted by the energy transition.
- The second study addresses the geophysical, technological, and economic aspects of climate change, with a focus on Portugal, and discusses economic policies aimed at dealing with its effects.

We hope and trust that these studies will make a positive contribution to "fact based decisions" and hopefully "good fact based decisions".

Our second action plan is the **implementation of internal sustainability practices**, namely in the management of the Bank's asset portfolio and the reduction of its ecological footprint as an organisation. About a year ago, we incorporated the ESG principles into our own asset management guidelines, and implementation is currently underway. Given the size of the Banco de Portugal's balance sheet, it is clear how important these guidelines can be for resource allocation in the investment portfolio. Among other initiatives, by the end of January this year, we joined the Lisbon Green Capital 2020 Commitment, an initiative of Lisbon City Council, through which the Bank has committed to take 10 actions, by 2030, in four key areas to tackle climate change -- i.e., energy, water, the circular economy, and citizenship.

The third priority action plan we have set out concerns the Bank's **intervention in national and international fora** where measures that may also have a potential impact on the Portuguese financial system are discussed. This is a field where much has happened, and on different "stages". At the national level, our involvement with the abovementioned think tank, which brings together financial supervisors, Government and industry, is the most relevant reference. At the international level, the Banco de Portugal currently takes part in 12 working groups, committees and other bodies specifically focused on this issue, within the European Central Bank, the European Systemic Risk Board, the European Banking Authority, the Bank for International Settlements and, of course, the NGFS.

Our concept of "integrating working groups" is not just about being there and listening to what other people have to say -- although this is also important. A key element of our participation is trying to provide an active contribution aimed at including in the discussion a number of issues that are relevant to our economy and our financial system. We must bear in mind that it is in many of these working groups that guidelines are prepared to be incorporated into the rules established at European level and applied to each of the EU member states. In a context where the rules under which we operate are increasingly set at European rather than national level, we need to be able to follow-up and monitor everything that can impact us through a supranational regulatory approach, aiming to avoid negative impacts and, if possible, influence decisions so that they can be positive for the economy and for the country as a whole.

Finally, the Banco de Portugal's fourth and last action plan to address sustainability challenges is **communication and cooperation with external entities**, which covers the establishment of contacts, networking, and the implementation of disclosure and other initiatives. In this field, the Bank has so far mostly participated in various conferences and seminars, published articles in specialised journals and cooperated with the media.

3. To what extent did the Banco de Portugal leverage the work of the NGFS in its own domestic journey? Any concrete examples?

The Banco de Portugal regards its engagement with the NGFS as particularly strategic to our own positioning in the area of sustainability and sustainable finance. Indeed, its specific focus on “greening the financial system”, the fact that it is a “coalition of the willing”, its global range – bringing together experiences, best practices and, increasingly, a common will to act, involving peers from all over the world – are features that set the NGFS apart.

The Bank is committed to sharing its own experience, while benefitting from close access to the experience of our peers, participating in the early discussion around issues of relevance to the Portuguese financial system and also trying to contribute towards the advancement of international efforts in this field. Indeed, since we began taking part in the network’s activities – notably, joining the various work streams established within it – our approach has been largely focused on providing inputs, as significant as possible, to the work undertaken by those bodies.

Conversely, the awareness to specific issues within the realm of sustainability and sustainable finance that was gained through our participation in the NGFS has actually spilt over to several areas of our activity in this field, be it through our participation in other national and international bodies or our own internal initiatives. That was the case in shaping our cross-cutting roadmap, the abovementioned “Commitment”, and many of the initiatives to be carried out under it. But also, for instance, in terms of such concrete NGFS outputs as the work on scenario analysis³ or the guide for portfolio managers⁴, which were and are important inputs to what the Banco de Portugal has been doing.

4. One last word?

It is only appropriate to go back to where we started – the involvement of Banco de Portugal with the NGFS. Having formerly been connected to the business world, where competition is the name of the game – therefore resulting in “winners” and “losers” – it is indeed a privilege to witness the remarkable ability shown by the global community of central banks and financial supervisors to share information and to cooperate in such an open and committed manner – thus creating only “winners”.

Against this background, the importance of contributing to a healthy technical debate within the NGFS and other fora cannot be understated. That is the path to follow if we seek to enjoy the fruits that come from having “the force of reason”, and not to endure the bitterness derived from being struck by “the reason of force”.

³ https://www.ngfs.net/sites/default/files/medias/documents/ngfs_climate_scenarios_final.pdf

⁴ <https://www.ngfs.net/sites/default/files/medias/documents/ngfs-a-sustainable-and-responsible-investment-guide.pdf>