



*In Conversation with*

*Ms. Fernanda Nechio*

*Deputy Governor for International Affairs and Corporate Risk Management,  
Banco Central do Brasil*

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

The Banco Central do Brasil (BCB) has been actively engaged in several international fora to account for and to mitigate the effects of social environmental risks in the financial system.

During the last two decades, the BCB has been scaling up its regulatory and supervisory framework, aiming to foster a greener financial sector in Brazil and to develop better corporate governance frameworks for risk assessment and management. Against this backdrop, in the last couple of years, the NGFS has been sending a strong and clear message towards promoting more efficient and sustainable financial systems, providing guidelines and setting best international practices for central bank policies on that front.

The common interests shared by the BCB and the NGFS to support the transition towards a sustainable global economy and financial sector drove the BCB to join the NGFS on March 25, 2020.

Climate change impacts advanced, emerging, and developing economies alike, and therefore, it calls for a globally coordinated action. The BCB believes that the financial sector should be at the center stage of the debate, due to the high volume of capital needed for the transition to a more sustainable economy, as well as the exposure of the financial sector to the risks associated with this transition. International cooperation is paramount to address the challenges ahead, and central banks should have a prominent role as financial regulators and supervisors in this area.

## **2. Can you share with us the key elements of Banco Central do Brasil's climate strategy and how it fits into the broader national strategy in your jurisdiction?**

The financial system in Brazil is an early starter in the sustainability agenda, with a long history of initiatives to foster green/sustainable finance and mitigate social and environmental risks.

In 1995, five major state-owned banks in Brazil signed the Protocolo Verde (“Green Protocol”), which set a charter of principles for sustainable development.<sup>1</sup> The Protocol proposed policies and practices to promote development without compromising the needs of future generations.

In the late 2000s, the BCB published<sup>2</sup> two regulations requiring financial institutions to verify borrowers’ compliance with the environmental legislation as one of the conditions to provide credit for rural activities.<sup>3</sup> The legislation aims at protecting the Amazon biome and fostering a low carbon emission agriculture.

In 2014, the BCB issued a resolution on Social and Environmental Responsibility, which set the ground and principles for socio-environmental (S&E) practices to be followed by financial institutions.<sup>4</sup> Under that resolution, financial institutions, licensed by the BCB, are required to have S&E risk management workplans and to implement a Policy for Socio-Environmental Responsibility (Política de Responsabilidade Socioambiental, PRSA)<sup>5</sup>. Each financial institution is required to implement a PRSA that is proportional to its exposure to environmental risks and to its relative importance to the financial sector, based on the nature of its services and activities.

In 2016, in its supervisory action plan, the BCB implemented the first version of a Socio-Environmental Risk Matrix, which considers both the S&E risks incurred by the financial institutions and the adequacy of their risk management action plan. Since then, the BCB has been continuously improving the components of financial institutions risk assessments, in close consultation with academic researchers and other jurisdictions.

In 2017, in an enhancement to the previous risk management regulations, the BCB devised an Integrated Risk Management Approach under which E&S risks are part of financial institutions’ structure. Under this integrated approach, financial institutions must identify, measure, assess, monitor, report, and mitigate E&S risks, in addition to other financial risks.<sup>6</sup> Financial institutions must also devise a risk management structure and governance to mitigate S&E and other risks. Additionally, financial institutions are required to consider S&E risks in their Internal Process of Capital Adequacy Assessment (ICAAP), with a mandatory disclosure of any S&E risks exposure in the financial institutions’ risk assessment process and in their calculations of capital adequacy.<sup>7</sup>

The BCB has been in close contact with the financial sector to promote appropriate strategies and policies to enhance environmental risk management. In recent years, the BCB has interacted with several agents of the financial sector to promote strategic discussions, the improvement of training and to promote best policy structures focused on environmental issues. The banking sector has welcomed this initiative, and the Brazilian Federation of Banks (Federação Brasileira de Bancos, FEBRABAN) created a social responsibility and sustainability commission, launching a self-regulatory taskforce to meet the BCB’s prudential standards.<sup>8</sup> In addition, several elements of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures recommendations are already being considered by all major financial institutions in Brazil, based both on regulatory requirements and on voluntary behavior.

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<sup>1</sup> Banco do Brasil, Banco do Nordeste, Banco da Amazônia, the National Bank for Economic Development (*Banco Nacional de Desenvolvimento Econômico e Social*, BNDES), and Caixa Econômica Federal.

<sup>2</sup> In Brazil, banking prudential regulation is proposed by the BCB and appreciated by the CMN. The CMN is currently composed by the Governor of the BCB, the Minister of Economy and the Special Secretary for the Minister of Economy. Supervision of the financial sector is carried out by the BCB.

<sup>3</sup> National Monetary Council’s (*Conselho Monetário Nacional*, CMN) Resolution no. 3,545/2008 and no. 3,896/2010.

<sup>4</sup> National Monetary Council’s (*Conselho Monetário Nacional*, CMN) Resolution no. 4,327/2014.

<sup>5</sup> The NGFS “Guide for Supervisors: Integrating climate-related and environmental risks into prudential supervision” presents this PRSA in Box 21.

<sup>6</sup> National Monetary Council’s (*Conselho Monetário Nacional*, CMN) Resolution no. 4,557/2017.

<sup>7</sup> Central Bank’s Circular no. 3,547/2011, later replaced by Central Bank’s Circular no. 3,846/2017.

<sup>8</sup> For more details see: <https://portal.febraban.org.br/pagina/3059/37/en-us/socioenvironmental-responsibility>

Finally, the BCB, together with the Ministry of the Economy, is part of a project sponsored by the German International Cooperation Agency (GIZ)<sup>9</sup>, to expand the market for sustainable finance in Brazil, and improve the supervision of S&E risks associated with its supervised entities. The project is expected to result in provisions and products that account for climate-related risks, in addition to contributing to the improvement of S&E and climate-change risks supervision.

To sum up, environmental risks are among BCB's top priorities. The BCB has been working towards developing a long-term strategy, and for that purpose, it will enormously gain from engaging on the discussions in international forums such as the NGFS.

### **3. To which extent did Banco Central do Brasil leverage the work of the NGFS in its own domestic journey? Any concrete examples?**

There is much to be done and understood in the climate change field. We need more research, targeted data, the development and integration of models into the existing frameworks of central banks, improved regulations, as well as enhancements to communication policies.

The BCB already considers different types of S&E events in its financial stability monitoring work. For example, it monitors possible impacts of defaults of economic sectors and their transmission channels through the financial system. In addition, under its supervisory role, the BCB has access to an extensive and granular data, which it intends to deepen and use to monitor S&E risks in the financial system. The BCB collects data on securities and deposits (from trade repositories), unit-level data on loans (under the BCB's operated credit bureau - SCR), and data received from other national agencies, such as the firms and labor registry records.

The use of such comprehensive data and information will continue to foster the supervisory work of the BCB and serve as the backbone of the BCB regulatory framework on S&E risks going forward. The BCB's closer engagement with the work from the NGFS will strengthen the much-needed global collaboration effort and further engage the BCB in international discussions. The exchange of experiences across NGFS members will further enhance the regulatory framework of the BCB.

### **4. One last word?**

It is quite clear that environmental events, once considered rare, are becoming more frequent. The economic impact of climate-associated events can be significant, and uncertainty is an inherent attribute of such events.

This new reality adds a layer of complexity to the outlook and enhances the importance of a globally coordinated discussion about the appropriate set of policy actions. Timely and strong coordinated actions are part of the recipe to mitigate risks and the effects of these adverse events, and the NGFS plays a central role in such coordination.

Brazil is a country of great potential and high exposure to environmental events, and of an important role in the region. Brazil's participation in the Network will prove relevant for ongoing and upcoming NGFS and BCB efforts.

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<sup>9</sup> Information about the project is available at: <https://www.giz.de/en/worldwide/76070.html>