



“PRINCIPLES FOR
ADDRESSING CLIMATE
SYSTEMIC RISKS WITH
CAPITAL BUFFERS”
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DISCUSSION BY
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Disclaimer: The views expressed are those of the presenter and not necessarily those of Banco de Portugal, the Eurosystem, or any of its policy committees.



CONTENTS

01

KEY TAKEAWAYS

02

DISCUSSION



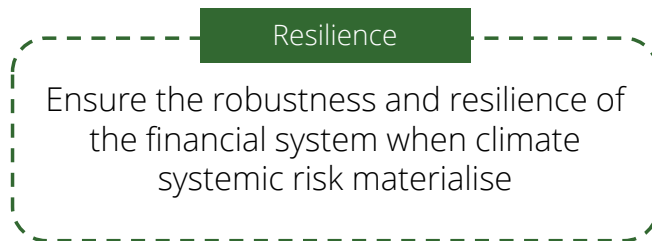
01

Key takeaways



“ANY SYSTEMIC FINANCIAL RISKS CALL FOR ADEQUATE MACROPRUDENTIAL POLICY; CLIMATE RISKS ARE NO EXCEPTION TO THIS RULE.”

- The policy brief mainly focuses on the role of systemic capital buffers in addressing climate systemic risk, with two main objectives:



- Systemic capital buffers are seen as an evolving and potential solution.



4 PRINCIPLES TO DESIGN AND OPERATIONALIZE A SYSTEMIC CAPITAL BUFFER FRAMEWORK

Absorption

- The Systemic Capital Buffers need to be calibrated to absorb climate systemic shocks by accounting for physical and transition risks, while reflecting the structure and vulnerabilities of the economy.

Prevention

- Systemic capital buffers need not only to induce and support actions to mitigate and adapt to climate change, but also to rely on forward-looking indicators to assess systemic risk mitigation by financial institutions. For the latter, supervisors can rely on qualitative and/or quantitative indicators.

Individualisation

- The Systemic Capital Buffers must have an institution-specific component reflecting individual exposure to climate risks and adaptation measures and a common systemic absorption component.

Recalibration

- The Systemic Capital Buffers must be recalibrated periodically to reflect the transition path of the economy and the risk profile of individual institutions.



02

Discussion

DISCUSSION



Overall comments

- ✓ The policy brief is very timely and policy relevant.
- ✓ The authors highlight the Systemic Capital Buffer as a key tool to address climate systemic risk. This view finds consensus among policy makers.

Ongoing discussion at the European and Portuguese levels

- ECB/ESRB Project Team on climate risk, that since 2022 has looked into how macroprudential policy can be employed to address the systemic dimension of these risks.
- Within capital-based measures, and as highlighted in the CRD VI, the systemic risk buffer (SyRB), or its sectoral version (sSyRB) that is applied only to exposures in a targeted sector, may already be used to address risks related to climate change.
- By Law, the Banco de Portugal has to publish an annual report on the exposure of the banking sector to climate risks and the impact of different climate/transition scenarios. This is a first and necessary step before thinking about the use of macroprudential policies.

DISCUSSION



The authors could extend the discussion along the following points.

Instruments to address climate systemic risk

- ✓ There is a consensus among policymakers that capital buffers are an important tool to address climate systemic risk.
- ✗ The authors could deepen the discussion on the role of other macroprudential instruments. For example, **within the EU toolkit**, three main designs are typically discussed: the general Systemic Risk Buffer (SyRB), which could involve different buffer rates for different banks' groups, the sectoral SyRB, and the SyRB with a concentration limit. This could be complemented by the BBMs.

Principle 1 - Absorption

- ✓ There is strong support for the idea of a capital buffer, the level of which would reflect the structure of the economy.
- ✗ However, from a macroprudential perspective, the level of capital buffers and expected profitability, other public and microprudential policies should also be taken into account.



DISCUSSION

Principle 2 – Prevention

- ✓ Macroprudential policy, by fulfilling the two objectives (resilience and mitigation), will support the smooth and orderly transition to a carbon-neutral economy.
- × The authors consider that the design of capital buffers should align incentives with sustainable goals, by rewarding (penalising) with lower (higher) capital requirements. However, a system risk-based approach should not be undermined.
- × There may also be challenges in assessing the relevance of firms' transition plans: credibility and accountability.

Principle 3 – Individualisation

- × The authors suggest that macroprudential buffers should include a component for institution-specific risks. However, the European approach differs, as it advocates for a sequential and complementary relationship between micro and macroprudential policies. In particular, capital buffers should focus on addressing the systemic dimension of climate risks once institution-specific risks have been addressed with through Pillar 1 and Pillar 2 instruments. This institution-specific dimension in the capital buffer and the potential overlap with microprudential capital requirements could be further explored.

DISCUSSION



Other comments

- **Coordination among jurisdictions.** The authors mention that "*setting higher capital requirements on bank loans might push firms to seek funding in other jurisdictions*". To what extent international coordination is needed, especially in common geopolitical areas?
- **Immediate action.** While the authors call for an immediate action, the discussion may consider pros and cons of acting early having **imperfect information** (e.g., lack of data availability) vis-à-vis the risk of acting too late.
- **Calibration of the capital buffer.** How the calibration of the buffer can be actually implemented, considering the importance of forward-looking information (e.g., stress-testing)?



Thank you
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