

**Banking Supervision Department**  
Supervisor of Banks

December 1, 2020  
REG19.013.003  
20LM3435

To: The banking corporations and credit card companies

**Re: Environmental risk management**

1. In recent years, there has been increased understanding that the potential realization of environmental and climate risks (hereinafter: environmental risks) could harm the economy, and could undermine the stability of the banks and the financial system, and in an extreme case could also lead to global contagion. Therefore, there is agreement among the various international organizations, including central banks and supervisory authorities in leading countries, that suitable operative measures must already now be taken to identify, monitor, and manage these risks in order to minimize as much as possible the increase in risk and in order to provide efficient tools to the financial corporations to minimize exposure to these risks and to deal with cases in which they are realized.
2. Environmental risk is a global risk that is derived from the potential damaging effects of environmental changes on people, ecological systems, and economic and financial activity. Such risks include climate change, damage to biodiversity, and pollution of the air, water, and land. These environmental challenges make it necessary to carry out preventive actions in order to minimize the damage, some of which is irreversible.
3. Environmental risks are commonly divided into two main risk factors: physical risks that are realized as a direct result of climate changes, such as fires, floods, earthquakes, and so forth; and transition risks that are due to the advancement of environmental quality processes and adjustments such as renewable energy, carbon reduction, “green” technologies and materials, and so forth.
4. Climate changes are at the forefront of these concerns. As part of the Paris Accord on Climate Change signed in 2015 that deals with reducing greenhouse gas emissions, minimizing the existing damage, and financing the treatment of greenhouse gas emissions by the world’s countries, it was decided to limit global warming to less than 2° Celsius compared with the pre-industrial period by 2050, and to 1.5° Celsius by the end of the 21<sup>st</sup> century. The State of Israel joined the agreement and undertook to meet the greenhouse gas emission reduction targets. This makes it necessary to take steps such as converting coal-fed electricity stations to natural gas, transitioning to renewable energy, and so forth.



5. Environmental risks have both financial and nonfinancial impacts on the banking corporations. These risks may also be included within other risks to banking corporations (such as credit risk, market risk, operational risk, compliance risk, legal risk, reputational risk, and liquidity risk), and may in extreme cases become prudential risks, as described in the Supervisor of Banks Letter on Environmental Risk Management published on June 11, 2009 (hereinafter: “the Supervisor’s Letter”)
6. The Banking Supervision Department attributes great importance to advancing this matter, and views the banking corporations as important partners in the transition to an environmentally sustainable economy, partly through the formulation of an environmental risk appetite, credit policy, investments, directing capital to “green” financing and investment activity, and more.
7. Beyond what is required in the Supervisor’s Letter, and as preparation for the treatment of environmental risks, the Banking Supervision Department intends to begin a round of discussions in order to begin the necessary early stages of the process in order to design and specify the aim of environmental risk management in the system.
8. As part of this, and in advance of the process, you are requested and expected to monitor the recommendations and guidelines published by leading international agencies dealing with the matter. These include, in part, response to supervisory expectations on the matter of risk management and disclosure.
9. For your convenience, as part of initiating the process, the following are references to documents that provide comprehensive explanations on the trends that are developing regarding the handling of environmental risks, including climate risks. The documents details the environmental risk management principles and expectations from the supervisors’ point of view, including implementation examples. It is important to note that the treatment of climate risks is still in its initial stages, and new documents are being published at a rapid rate. Therefore, with a view to the future, your monitoring of the publications by international agencies and leading supervisory authorities on this matter is of the utmost importance.
10. The following are the references to a number of documents published on this matter:
  - 10.1 Draft of supervisory expectations published by the European Central Bank (ECB) in connection with the management and disclosure of climate risks and environmental risks
    - [Guide on Climate-Related and Environmental Risk. Supervisory Expectations Relating to Risk Management and Disclosure, May 2020.](#)
  - 10.2 A discussion document by the European Banking Authority (EBA) that identifies and explains the environmental risk factors and reflects existing and developing initiatives undertaken by supervisory bodies and corporations in recent years.
    - [On Management and Supervision of ESG Risks for Credit Institutions and Investment Firms, Discussion Paper, October 2020.](#)

10.3 Guidelines for the integration of climate risks and environmental risks in prudential supervision, published by the Network for Greening the Financial System (NGFS), which brings together supervisory authorities from around the world and is intended to make the banking system green.

- [Guide for Supervisors. Integrating Climate Related and Environmental Risks into Prudential Supervision, May 2020.](#)

10.4 A document by the NGFS that includes examples of tools and methodologies for scenarios and stress tests to analyze environmental risks by financial corporations.

- [Overview of Environmental Risk Analysis by Financial Institutions, September 2020.](#)

10.5 Recommendations published by the Task Force on Climate-Related Financial Disclosures (TCFD) established by the FSB, for the disclosure of climate risks by many companies including financial firms. The team's recommendations were first published in June 2017.

- [Guidance on Risk Management Integration and Disclosure, October 2020.](#)

- [Recommendations of the Task Force on Climate-Related Financial Disclosure, June 2017.](#)

11. As noted above, the Banking Supervision Department intends to hold meetings with you to share and obtain information on the level of awareness and preparedness, and on practices that you may have formulated on the matter of environmental risk management, and their adaptation to expectations. After that, we will outline the continuation of the process, as part of which we will send you a questionnaire on environmental risks. Your answers to it will form the basis of further discussions that we will hold with the risk managers at your institution.

Sincerely,

Yair Avidan

Supervisor of Banks