Bank of Albania

Guideline on climate-related and environmental risks

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1. General provisions

1.1 Objectives

The object of this document is to define the expectations of the Bank of Albania in terms of:

a) orientation, preparation of the banking sector for the assessment, measurement, administration and control of financial risks related to the climate and the environment;

b) orientation of the banking sector to effectively and comprehensively address financial risks related to the climate and the environment, during the evaluation and implementation of the business strategy, internal governance and risk management;

c) increasing human capacities to engage in climate change analysis;

d) defining the reporting models on banks' self-assessments related to their preparation for the transition to a more environmentally friendly approach, as well as to the fulfillment of supervisory expectations;

e) achieving greater transparency through the timely and adequate disclosure of sufficient information and data related to climate and environmental risks.

1.2 Subjects

This guideline are addressed to banks that are licensed and operate in the territory of the Republic of Albania.

1.3 Scope of application

Risks related to climate change and the environment are becoming increasingly important, and the banking system plays a crucial role in these changes, as it serves as a facilitator of reorienting for capital flows towards a more sustainable economy. In this process, climate change and the transition to sustainable activities constitute a source of risk for the bank.

This document sets out general requirements for banks, based on rules and principles, for the safe and prudent management of financial risks related to climate and the environment.These requirements come in the form of supervisory expectations for banks, through which it is intended to facilitate the transition of banks towards sustainable activities and prepare them for future

regulatory changes related to climate-related risks. Banks are free to choose and use their own methods, within the existing legal and regulatory framework, to identify risks related to climate and environmental changes as drivers of existing risk categories.

Banks integrate climate risks into the overall risk management framework to avoid unexpected losses. The guide provides instructions regarding the strategic assessment of the aforementioned risks, governance and internal organization in their administration.

Banks adapt the recommendations of this guide with reference to the nature and model of their business and in accordance with the services they provide, including the specifics arising from the organizational structure, size and complexity of the bank, risk profile and risk exposure.

Although this guide focuses more on climate and environment-related risks, it is important to note that these developments also offer potential business opportunities for banks, which may include the development of new, even innovative, forms of financing.

2. RELEVANT DEFINITIONS

For the purposes of this guideline, the following terms are used:

a) **Environmental, social and governance (ESG) risks** represent the probability of losses or additional costs, or the loss of planned income, or the loss of the bank's reputation due to the negative financial impact of current or future ESG factors on other contractual parties and their property.
b) **ESG factors** refer to environmental, social or governance matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual.
c) **Climate-related and environmental risk-related strategic objectives and/or limits** are determinations which aim at managing a bank’s exposure to climate-related and environmental risks, over the short-, medium- and long-term time horizons.
d) **Climate-related risks** are the financial risks posed by the exposure of banks to counterparties that may potentially contribute to or be affected by climate change.
e) **Environment-related risks** are the financial risks arising from banks' exposure to counterparties that can potentially cause or be affected by environmental degradation (such as air pollution, water pollution, freshwater scarcity, land and desertification, loss of biodiversity and deforestation) and loss of ecosystem services.

   “Financial risks related to climate and the environment” can appear as transition risks or as physical risks.

f) **Transition risks** refer to the risks to banks arising from the transition to a low-carbon and climate resilient economy:
   (i) **Policy-regulatory risks**, for example those arising from energy efficiency requirements, carbon pricing mechanisms that increase the price of fossil fuels, or policies that promote sustainable land use.
   (ii) **Technological risks**, for example when a technology with a less harmful impact on the climate replaces a technology with a more harmful impact on the climate.

(iii) **Market risks**, for example if consumer and corporate client preferences and demand shift towards less climate-damaging products and services.

g) **Physical risks** are risks to banks arising from the physical effects of climate change:

(i) **Acute physical risks** are sudden short and severe events that have a significant negative impact, arising from specific events, in particular weather-related events such as storms, floods, fires or heat waves, which can damage production facilities and disrupt value chains.

(ii) **Chronic physical risks** are those resulting from longer-term changes in climate, such as changes in temperature, rising sea levels, declining water resources, loss of biodiversity and changes in soil fertility.

h) **Greenhouse gases (Green House Gases GHG)** are gaseous components of the atmosphere, both natural and anthropogenic (related to humans), which absorb and emit radiation at certain wavelengths within the spectrum of thermal infrared radiation emitted by the Earth's surface itself atmosphere and clouds. This property causes the greenhouse effect. Water vapor (H_2O), carbon dioxide (CO_2), nitrogen oxide (N_2O), methane (CH_4) and ozone (O_3) are the primary greenhouse gases in the Earth's atmosphere.

i) **Green economy (low-carbon economy)** means an economy with low carbon emissions that uses resources efficiently and is in the public interest.

j) **Green lending/investment** (the broad term "green products") refers to lending, investment or other financial products of the bank, which depend on ecological criteria for the planned use of funds, with the aim of reducing the adverse effects of activities on the environment or risks to environment.

k) **Greenwashing** refers to the practice of gaining an unfair competitive advantage on the market by advertising a financial product as environmentally acceptable, when in fact the basic environmental standards are not met.

l) **Risk appetite** means the aggregate level of types of risk a bank is willing to assume within its risk capacity, in line with its business model, to achieve its strategic objectives.

m) **Taxonomy of economic activities** means a classification system in which a list of ecologically sustainable economic activities and thresholds can be used to clearly determine which economic activity is in accordance with sustainable development, environmental goals and principles of sustainable economic activity. Such a taxonomy helps investors, issuers and project promoters to focus on the transition to a low-carbon and more resource-efficient, risk-resilient economy, as well as facilitates a climate-related information disclosure system. Since there is currently no taxonomy in force in Albania, the bank will develop these definitions internally and apply them to the products it offers to its clients as necessary. For these purposes, the bank can use definitions from other international practices (e.g., Taxonomy of the European Union [1]). According to the principle of proportionality, the applicable taxonomy should be adequate to the nature, scope, size and business model of the bank.

[1] https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32020R0852

3. SUPERVISORY EXPECTATIONS FOR BUSINESS MODEL AND STRATEGY

1. Climate-related and environmental risks may directly affect the business environment of banks. The bank identify the risks arising from climate change and environmental degradation at the level of key sectors, geographical areas as well as in relation to products and services in which they operate or plan to operate, taking into account that some of these risks may materialize over a fairly medium to long period of time. Furthermore, as changes to the business model need some time to become operational, early and prompt action may be needed even in cases where vulnerabilities are identified only in the medium to long term.

> Climate-related and environmental risks can affect, for example, economic growth, employment or property prices at national, regional or local level. Weather events can cause droughts or floods that affect a region's agricultural production, housing demand or the value of collateral at national, regional or local level. In parallel, competition is influenced by the development of a green financing market and consumer preferences that are shifting away from high carbon or otherwise polluting goods and services towards low carbon or otherwise "green" products and services. In the domain of technology, banks serving clients in energy-intensive industries and power plants that rely heavily on fossil fuels (i.e., coal-fired power plants) may see their clients face significant investment requirements to de-carbonize their energy mix. Thus, in identifying risks, a bank may categorize its clients or portfolios according to climate risk exposures. For example, geographic grouping can help to identify exposures that are exposed to high physical risks, such as high risk of flood or drought. Sectoral categorization can help to identify transition risks, for example by assessing the share of highly GHG-intensive sectors in the lending portfolio.

2. Climate-related and environmental risks can have a direct impact on the effectiveness of a bank's existing and future strategies. The bank identify and assess which climate-related and environmental risks are material to them in the short, medium and long term, and the resilience of their business strategy to these risks. The time horizon is particularly relevant, as most climate-related and environmental risks are expected to manifest themselves in the medium-to-long terms, usually going beyond the common banks' business planning cycles.

3. Within this framework, the bank adequately document the processes by which they assess the significance of climate-related and environmental risks to their business environment.

4. The implementation of a bank's business strategy is expected to reflect the bank's consideration of significant climate change and environmental risks. The process will be more credible if banks define and monitor long-term key performance indicators (hereinafter: "KPIs"), as well as key risk indicators (KRIs) that should be quantitative, when feasible. Depending on the nature, complexity and scale of the bank's activities, these indicators may be cascaded down across business lines, clients and products, where they are material and relevant.

Indicators that set a specific target for green or social loans may, for example, be cascaded down or broken down into corporate clients; individuals; business activities or economic sectors; types of loans (e.g., consumer loans, mortgages, credit lines, etc.); geographic situation; etc.

5. The bank consider the impact that their business models and strategy development may have on the environment, for example through measuring and limiting the GHG emissions or resource efficiency of their main portfolios or that stem from their own activities. Banks take steps to mitigate the transition risks, for example by gradually or even rapidly reducing and phasing out financing of environmentally unsustainable activities. A good practice for a bank is to develop a carbon neutrality plan in line with the overall climate-related and environmentally sustainable objectives (i.e., those established nationally and internationally[2]).

Climate-related and environmental risks are likely to affect different regions, economic sub-sectors, types of borrowers and assets differently. In light of this, the banks' overall objectives and targets may need to be translated into more specific targets (or limits), including exclusion policies for certain regions, sub-sectors or activities (e.g., specific sectors or types of counterparties due to highly polluting production).

6. Banks assess whether to develop sustainable products that are considered to be more resilient to climate-related and environmental risks. These include products typically marked as 'green'. Banks can use such products as a tool to implement their climate-related and environmental risk objectives and adjust their business models and portfolio composition. Banks that originate or plan to originate environmentally sustainable credit facilities should develop, as part of their credit risk policies and procedures, specific details of their environmentally sustainable lending policies and procedures, covering the granting and monitoring of such credit facilities. Banks should position their environmentally sustainable lending policies and procedures within the context of their overarching objectives, strategy and policy related to sustainable finance, and assess the extent to which the development of their environmentally sustainable lending activity is in line with, or is contributing to, their overall climate-related and environmental risks objectives and/or limits.

[2] Including, but not limited to, the Paris Agreement, United Nations Framework Convention on Climate Change (UNFCC), National Determined Contributions (NDC), etc.). These efforts are also in line with the objective of Article 2(1)(c) of the Paris Agreement.
Article 2(1)(c) objective of the Paris Agreement: "Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."
https://treaties.un.org/doc/Treaties/2016/02/20160215%2006-03%20PM/Ch_XXVII-7-d.pdf

For the purposes of this guideline, climate-related and environmental strategic objectives and/or limits are understood as determinations which aim at managing a bank's exposure to climate-related and environmental risks, over the short, medium and long-term time horizons. For example, banks could set strategic objectives and/or limits regarding the proportion of their exposures to certain economic activities or sectors. In contrast, objectives or limits which do not relate to the resilience of the business model and whose purpose is not to effectively enhance the bank's management of climate-related and environmental risks are not considered climate-related and environmental strategic objectives and/or limits. Further, banks should bear in mind that setting strategic objectives will be likely to alter their overall risk profile, resulting in a need to review their risk appetite.

4. SUPERVISORY EXPECTATIONS FOR INTERNAL GOVERNANCE

7. Climate-related and environmental risks areincluded in the internal governance system in a bank Accordingly, the Steering Council and management must have sufficient knowledge and understanding of climate-related and environmental risks to ensure that the level of risk assumed is consistent with the bank's risk appetite and risk strategy, internal procedures and policies, and that the bank complies with applicable legal requirements and other obligations on banking supervision.

For example, it is considered to be a good practice if the Steering Council receives regular reports on climate-related and environmental risks or is regularly informed about them under a dedicated agenda item at its meetings.

8. In the application of Article 5 of the Regulation "On core management principles of banks", and Section II[3] of the Guideline "On internal governance of banks", the Steering Council of the bank have adequate collective knowledge, qualifications and experiences also with regard to climate-related and environmental risks. Banks require key personnel to have expertise in climate-related and environmental risks relevant to the performance of their duties and for members of the Steering Council and key personnel to be familiar with the climate-related and environmental risks of the bank as soon as at the start of their employment, as part of their on-boarding and training for their duties.

9. Banks clearly delimitate the internal organisational structure and responsibilities of each function and individual person performing control functions with regard to climate-related and environmental risks, in line with the general principles on internal control system and control function in relation to the general responsibilities under applicable regulations and laws, and describe the mandate, work processes and objectives for these functions. It is the responsibility of the Steering Council to ensure that the relevant responsibilities are clear, well defined, consistent, enforceable and adequately documented.

[3] "Individual and collective suitability criteria of the members of the steering council"

10. When setting the internal duties and responsibilities for the management and control of climate-related and environmental risks, banks choose among one of the following options:

    a) A separate organizational unit or function responsible for the management and control of climate change and environmental risks is established within the bank. Where the bank establishes a separate department or function for climate-related and environmental risks, it is expected that the integration of the separate department or function into existing processes and its relationship with other functions is clearly defined (division of responsibilities and duties, cooperation and reporting obligations, etc.).

    b) An executive director or a member of the Steering Council is designated responsible for the management and control of climate-related and environmental risks – in charge of an area with a control function other than the internal audit function – subject to an appropriate separation of duties and responsibilities.

11. In accordance with Article 13(3) of the Regulation "On core management principles of banks" and Paragraph 33.3 of the Guideline "On internal governance of banks", banks ensure that the functions involved in managing climate-related and environmental risks have adequate resources, both human and financial, and have sufficient status and authority to fulfil their role effectively. Banks provide relevant training opportunities for their staff focused on climate-related and environmental risks and consider the possibility of a general environmental and climate-related awareness training.

12. In line with the general requirements of the Regulation "On core management principles of banks" and Paragraph 2.6 (Section I[4]) of the Guideline "On internal governance of banks", the Steering Council is expected to exercise effective oversight over the bank's exposure to climate-related and environmental risks and regarding the impact of the business strategy on climate and environmental sustainability objectives.

13. In order to take a comprehensive approach to risk, taking into account the long-term financial objectives of the bank, it is recommended for the Steering Council to develop the bank's response to the general climate-related and environmental risks, and sustainability objectives in the form of a climate-related and environmental risks strategy. In this sense, it is expected that banks integrate climate-related and environmental risks into their risk culture.

14. Remuneration policies and practices are expected to contribute to a long-term approach to addressing climate-related and environmental risks. Banks set indicators related to climate and sustainable finance in their remuneration policies, and those indicators shall be embedded in the business strategy and/or risk management framework of banks.

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[4] "Steering Council".

15. Banks integrate both climate-related and environmental risks into their internal reporting systems, in accordance with Article 11(3)(a) of the Regulation "On core management principles of banks", on their risk exposures and risk profile. Reporting systems shall provide all relevant levels of management in the bank with reliable, complete, object and timely information necessary for making business and risk decisions. In the short term, banks shall assess their data requirements from their strategy development and risk management units, identify data gaps, and outline plans to address them and overcome any shortcomings.

16. The internal control shall ensure that the bank has effective and reliable internal and external data reporting, disclosure and communication systems that are capable of aggregating climate-related and environmental risks data. Given the nature of climate-related and environmental risks, banks assess the need to adapt their information systems to be able to collect and aggregate the necessary data to assess their exposure to these risks.

5. SUPERVISORY EXPECTATIONS FOR RISK MANAGEMENT

5.1 Risk management system

17. Banks have a comprehensive and well-documented picture of the impact of climate-related and environmental risks on existing risk categories. Climate-related and environmental risks may be considered as factors affecting existing risk categories, but banks may treat these risks as a separate risk category for organizational or analytical purposes. Examples of factors that trigger climate-related and environmental risks and and how they result into other existing risk categories are given in Annex 1.

> For example, extreme weather events (e.g., drought) may be considered as a factor affecting credit risk (as an existing category) in agricultural lending, whereas other physical risks (i.e., floods) may influence several risk categories simultaneously (i.e., credit risk, operational risk, liquidity risk).
>
> Nevertheless, banks may treat them as part of a separate stand-alone risk category called "ESG", "climate" or other.

18. Banks take steps to quantify climate-related and environmental risks. Banks make proportional efforts (according to their nature, size dhe complexity) to use quantitative indicators for this quantification, seeking to put any remediation actions to the data shortcomings they may face.

19. In line with Article 11 of the Regulation "On core management principles of banks", banks consider the need to review their risk management policy and other internal acts defining in

detail the functions, systems, processes, procedures, activities and methodologies, as well as competencies, responsibilities (collective and individual) and reporting lines at all levels of the bank's organizational structure, in light of climate-related and environmental risks.

20. When reviewing their risk appetite, banks develop appropriate risk indicators and set appropriate limits for climate-related and environmental risks at counterparty, sectors, and geographical areas level where relevant. Banks also monitor and disclose, where available, its policies for economic sectors, geographical exposures, current data on climate-related and environmental risk exposures, preferably in the form of quantitative measures, based on a combination of historical data and forward-looking estimates, in accordance with the requirements in section **Error! Reference source not found.** “Supervisory expectation for disclosures” of this document.

5.2 Credit risk management

21. In line with the requirements set out in Article 9 of the Regulation 62/2011 “On credit risk management from banks and branches of foreign banks” (hereinafter, the Regulation “On credit risk management”), banks develop specific details of their environmentally sustainable credit risk internal strategy, policies, procedures and rules of the bank. Banks set out their environmentally sustainable policies and procedures on exposure approval in line with their overall objectives, strategy and policy on sustainable finance. Defining environmental sustainability lending requires the development of new internal set of criteria or the incorporation of existing or forthcoming standards into the credit risk policy and credit strategy.
22. Banks consider climate-related and environmental risks at all relevant stages of credit risk/exposure approval and credit risk management.
23. For large corporate clients, in lending and risk management process, banks have an updated view on:

    (i) the sustainability of the client,

    (ii) the client exposure to the physical and transition risks and

    (iii) the climate change mitigation plans for the client.

    Banks may incorporate into their credit risk ratings these aspects, to broaden its understanding on the impact that the alignment of a client with climate-related and environmental factors may have in its credit risk.

24. In addition to exposure approval, banks understand the use of the loan, and particularly, if the loan is being used for funding sustainable or unsustainable activities, in accordance with the

criteria defined by the bank as part of its environmentally sustainable credit risk policy. Banks request this information directly from their clients and update it regularly. Furthermore, the process of credit risk management also requires procedures and methodologies through which banks can verify that the loan has in fact been used to finance sustainable activities, which should include the following:

a) Collecting information about the climate-related and environmental or otherwise sustainable business objectives of the borrowers.

b) Assessing the conformity of the borrowers' funding projects with the qualifying environmentally sustainable projects or activities and related criteria.

c) Ensuring that the borrowers have the willingness and capacity to appropriately monitor and report the allocation of the proceeds towards the qualifying environmentally sustainable projects or activities.

25. For loans to other legal entities, banks request information on the use of their loans before its approval and assessing whether the loan is being used for qualifying environmentally sustainable economic activities or, at least, that the loan is not being employed to fund non-qualifying sustainable economic activities that have been restricted or limited in accordance with the bank's risk appetite or the bank's internal credit policies. The bank shall also consider the exposure to physical and transition risks for clients based in regions or operating in sectors that the bank considers to be particularly vulnerable to these risks.

26. For loans to individuals, the bank ensure that, when a "sustainable product" is defined (e.g., "green loans") that the loan features are consistent with the definition of the product and that the funds have been deployed accordingly. Banks also assess the exposure to physical risks of clients that are assessed to be particularly expose to physical risk (i.e., those living in areas at high risk of flooding).

27. Banks conduct climate-related and environmental risks assessment on their clients both before and after approval of risk. This is considered to be a good practice if it includes the collection and verification of information and data necessary to assess the vulnerability of borrowers to climate-related and environmental risks, in particular before entering into a credit agreement or a significant modification thereof, in line with the bank's internal policies and procedures, and following the principle of proportionality and considering the nature of the client and its activities. Furthermore, banks be aware of their clients' attitudes to managing these impacts and risks.

For example, banks may consider using analytical tools that highlight the climate-related and environmental risks of each economic (sub)sectors on a graph or scale. For loans or borrowers with higher climate-related and environmental risks a more comprehensive analysis of the borrower's business model is required, including a review of current and projected GHG emissions, the market environment, regulatory environmental requirements, an analysis of the likely impact of regulation concerning the environmental aspects on the borrower's financial position.

28. Banks take climate-related and environmental risks into account when assessing collateral, as they may affect the value of the collateral.

For example, in this respect, it is recommended for banks to take into account the location of the commercial or residential property, its technical and energy characteristics, the efficiency of the mechanical engineering systems, etc.

29. Bank's credit pricing framework reflect climate-related and environmental risks and those are to be reflected in its credit risk appetite (i.e., by specifying risk limits, tolerances and thresholds) and business strategy too.

For example, as part of defining its business strategy and risk appetite, banks may choose to reduce or limit their exposures to sectors that are harmful to the environment or climate, while increasing their exposures to sectors that have a positive impact on the environment or climate.

Thus, the pricing framework is expected to support the choosen risk perspective and strategy, for example by differentiating the price of loans according to the energy efficiency of the exposures or by applying sector- or client-specific fees.

In line with their business strategy and risk appetite, banks may also consider encouraging their clients to take due account of climate-related and environmental risks in order to improve creditworthiness and resilience to such risks. This may involve, for example, that banks offer a reduced interest rate on an environmentally sustainable loan or linking the interest rate of the loan to a sustainability target to be achieved by the client that contributes to or is consistent with the overall climate change-related and environmentally sustainable goals.

In the definition of its credit risk appetite, banks assign quantitative metrics to climate-related and environmental risks, particularly for physical and transition risks. Banks also determine relevant risk appetite indicators and limits based on the level of risk that the bank is willing to assume within its risk profile, in line with its business model.

30. Banks monitor and manage climate-related and environmental risks in their credit portfolios based on the general requirements of the Regulation “On credit risk management”, for instance through concentration analysis and stress testing. For example, banks monitor and manage

concentration risk through managing conentrations within financial risks types that are climate and enviroment related, such as the exposure to certain economy sectors or geographical areas.

5.3 Operational risk management

31. Banks assess the impact of physical risks arising from climate change on their own operations, including their ability to quickly restore their capacity to continue providing services. The geographical location in which a bank operates may make it more susceptible to physical risks. This is particularly relevant for outsourced services and IT activities, especially if service providers are located in locations with a higher risk of extreme weather events or other environmental vulnerabilities.
32. In particular, when assessing critical functions, banks consider the impact of climate change on the provision of such functions/services. Where the outcome of that assessment is material to any business line or the overall operations of the bank, it is recommended to be reflected in the bank's business continuity plan.
33. In a broader view, banks consider the extent to which the nature of the activities it carries out increases the future risk of reputational damage. In order to avoid legal and reputational risks related to environmental and climate risks, banks assess whether their investment products comply with international best practices.

> For instance, a bank that is involved in financing activities that are publicly controversial (e.g., fossil fuel financing, financing a company that has been accused of breaking child or forced labor rules, etc.) might see their reputation impacted or might be subject to legal claims.

34. Additionally, banks strive to reduce their own ecological and carbon footprints, as insufficient knowledge of these or failure to reduce them effectively, in addition to preventing constructive contributions to the efforts required by international agreements, also entail reputational risks. So, it is considered to be a good practice for banks to operate an environmental management system that complies with internationally accepted standards. Furthermore, by measuring and seeking to continuously improve their environmental performance, banks show their continuous dedication towards sustainable activities.

a) As regards the GHG emissions, the following is proposed:

   i. Measuring direct emissions from own activities (Scope 1)[5].
   ii. Measuring indirect emissions related to purchased energy (Scope 2).
   iii. Measuring other indirect emissions (Scope 3), with the financed emissions primarily related to credit and market risk management rather than to operational risk management.

b) As regards other environmental impacts of operations and measures to reduce them, the following is recommended:

   i. Introduction and promotion the use of cashless payment methods.
   ii. Reduction in the use of paper for client and/or product contracting promoting the use of digital media.
   iii. Other initiatives related to own operations, along the validated environmental performance indicators.

c) As regards the ecological footprint, the following is proposed:

   i. Reducing the use of paper and water both in bank's headquarters and branches.
   ii. Promoting the teleworking in order to reduce staff mobility and, thus, the use of cars and other means of transport.
   iii. Ensuring long-term contracts with electricity suppliers ensuring energy renewable sources.
   iv. Other ways that may either ensure the reduction of the ecological footprint or may contribute to its fight.

5.4 Market risk management

35. Regarding the management of market risk, banks take into account that environmental and climate risks may lead to shifts in the supply and demand of financial instruments (e.g., securities, derivatives), products and services, which may affect their value.

36. Banks that invest in companies with business models that are assessed as environmentally unsustainable, located in geographical areas exposed to physical risks may suffer a decline in the value of their investments as a result of policy measures, changes in market sentiment or technology, or as a result of gradual adverse changes in severe weather events or climatic conditions.

[5] Detailed information on the scopes is available in the GHG Protocol standards: https://ghgprotocol.org/

37. This is relevant when financial instruments issued by companies in sectors that are assessed as environmentally unsustainable or that do not apply a comprehensive sustainable governance approach suffer a sudden drop in value.

5.5 Liquidity and funding risk management

38. Banks consider whether climate-related and environmental risks impact their liquidity or funding position. Where these risks are considered material, it is recommended that, following article 12 of the Regulation 14/2009 "On liquidity risk management", banks take steps to identify, assess and manage the impact of climate-related and environmental risks impact in its liquidity and funding position over appropriate time horizons and to maintain adequate liquidity buffers, within the framework of the legislation on liquidity risk measurement and management.
39. The previous assessment shall be conducted in a forward-looking manner, assuming both business-as-usual and stressed conditions, and, in particular, to consider severe but plausible scenarios that may occur in combination, with a focus on key vulnerabilities, by assessing whether climate-related and environmental risks could have a material impact on bank's liquidity or funding position.

On the one hand, climate and environmental factors can influence the value of financial assets, which in turn might affect the capacity to trade that asset, thereby creating short-term liquidity risk. This risk can also arise as the result of climate or environmental events triggering a deposit run on the bank: environmental crises, such as social unrest, can lead to higher withdrawals or put stress on the liquidity position of the bank in a specific geographical area.

On the other hand, climate and environmental factors can affect the availability and/or stability of funding (e.g., hampered or more expensive access to market funding, unstable deposits due to changing customer preferences, etc.), thereby creating medium- or long-term funding risk. In this context it is important to acknowledge the potential effect of reputational issues on the funding of banks.

5.6 Scenario analysis and stress testing

40. Banks assess climate-related and environmental risks through the use of scenario analysis and/or stress testing. In this sense, it shall be highlighted that unlike traditional stress tests, the most dramatic impacts of climate-related or environmental risks are likely to happen in the medium to long term, and therefore a considerably longer time horizon will be required for these exercises.

41. Banks consider the use of scenarios that are consistent with scientific climate change trajectories, such as the Intergovernmental Panel on Climate Change (IPCC) scenarios or estimated NGFS scenarios. Banks take into account at least the following aspects when conducting sensitivity, scenario analysis and stress testing as regards climate-related and environmental risks:

    a) How physical and transition risk may affect the bank.
    b) How climate-related and environmental risks might evolve under different scenarios, taking into account the features of this type of risk (uncertainty and non-linearity, probability that cannot be based on historical data, potentially extreme and widespread impacts).
    c) How climate-related and environmental risks may occur in the short, medium and long term, depending on the scenarios considered.

42. Banks define their own risk profile and assumptions regarding its specific features, and it is also recommended considering several scenarios based on different combinations of assumptions. Within its capital mapping framework, banks assess their capital adequacy against a credible baseline and bank-specific adverse scenarios. Banks shall assume exceptional but plausible events of sufficient severity in terms of their impact on capital adequacy, in accordance with article 17, paragraph 1 of the Guideline 60/2019 “On the approval of the guideline on bank’s stress testing”.
43. Banks interpret the results of stress tests and, if necessary, to take clear risk mitigation measures based on them. Stress testing programs shall be communicated effectively across all relevant business lines and at executive directors level in order to raise risk awareness, improve risk culture and facilitate dialogue within the organization on possible risk management measures.

6. SUPERVISORY EXPECTATIONS FOR DISCLOSURES

44. Banks disclose the information on climate change and environmental financial risks based on their materiality, in accordance with the definitions laid out in Regulation 60/2008 “For the minimum requirements of disclosing information from banks”.

45. Where a bank does not consider climate-related and environmental risks to be material and, thus, omit its disclosure, banks document this decision with qualitative and quantitative information supporting the assessment.

46. Where a bank considers climate-related and environmental risks to be material, it shall disclose the methods definitions and criteria related to them.

47. Banks follow the principle of proportionality in disclosing the total GHG emissions it finances in addition to its own GHG emissions by adopting a sufficiently detailed approach to measuring and disclosing GHG emissions.

This may, for example, require a project-by-project approach to measuring the carbon intensity of large corporate portfolios, as well as a property-by-property measurement of actual energy consumption or an energy efficiency rating of property portfolios.

48. Banks commit to contribute to the achievement of overall climate change and environmentally sustainable objectives. Banks provide a comprehensive overview of the impact of the bank as a whole, providing comprehensive and meaningful information on how it contributes to the former objectives, in order to avoid greenwashing risk[6].

49. Given the rapidly evolving climate-related and environmental risk disclosure frameworks and the needs of market actors in this area, it is recommended that disclosures are actively developed on an ongoing basis.

50. It is considered a good practice to disclose the progress on the steps taken, in relation to the above-mentioned proposals, in the context of sustainability or integrated reports.

7. REPORTING TEMPLATES

51. With the publication of this document, the bank assesses the compatibility of its current practice of managing and publishing information on climate-related risks and the expectations set out in this guideline. Banks determine the improvement of existing practices through the construction plan of adaptation and implementation of these expectations.

52. For the purposes of this guideline, the bank reports:
    a) The self-assessment template according to annex 2 of this document where the practices described in this document will be presented.
    b) The action plan template according to annex 3 of this document, where the plans aimed at progressively addressing these expectations are presented.
    c) The template for tracking the status of the action plan according to annex 4 of this document.

[6] **"Greenwashing"** refers to the practice of gaining an unfair competitive advantage in the market by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met.

8. ANNEX

8.1 Annex 1: Examples of factors driving climate and environment-related financial risks and how they affect other existing risk categories.

Risks affected	Physical		Transition	
	Climate-related	**Environmental**	**Climate-related**	**Environmental**
	Extreme weather events: • Drought • Flooding • Thunderstorm • Heat waves • Landslides • Fire • Earthquakes Chronic weather patterns: • Extreme weather changes • Ocean acidification • Increase in temperatures • Sea level rise • Changing rainfall patterns	Examples: • Pollution • Water stres • Soil pollution • Resource scarcity • Desertification • Deforestation • Biodiversity loss • Lack of resources	Examples: • Policy and regulation • Carbon price • Technology • Market sentiment	Examples: Policy and regulation • Pollution control • Control of pesticides • Measures to protect the environment • Technology • Market sentiment.
Credit	The ability to pay or the repayment of the exposure can be affected for example: • from the reduction of income after a climate event (eg, increased costs to adapt to new technologies, or increased investment, increases expenses and decreases income. This can affect the ability to pay and more limited access to financing). • decline in the value of collateral in real estate portfolios as a result of increased flood risk/damaged properties/lower food crop yields		Energy efficiency standards may trigger substantial adaptation costs and lower corporate profitability, which may lead to a higher PD as well as lower collateral values.	
Market	Severe physical events may lead to shifts in market expectations and could result in sudden repricing, higher volatility and losses in asset values on some markets.		Transition risk drivers may generate an abrupt repricing of securities and derivatives, for example for products associated with industries affected by asset stranding.	

Operational	The bank's operations may be disrupted due to physical damage to its property, branches and data centres as a result of extreme weather events.	Changing consumer sentiment regarding climate issues can lead to reputation and liability risks for the bank as a result of scandals caused by the financing of environmentally controversial activities.
Other risk types (liquidity, business model)	Liquidity risk may be affected in the event of clients withdrawing money from their accounts in order to finance damage repairs.	Transition risk drivers may affect the viability of some business lines and lead to strategic risk for specific business models if the necessary adaptation or diversification is not implemented. Banks' liquidity may be affected by a sudden repricing of securities due to transition risk factors.

8.2 Annex 1. Self-assessment: template and instructions

53. This Annex provides banks with both a standardized template and instructions that banks follow to report the Bank of Albania with the information on any existing divergences in the bank's practices from the supervisory expectations described in this guideline, as described in paragraph 52.a):

Section	Subsection	Description of bank's status	Bank's compliance status	Additional comments	# deficiency
3. Supervisory expectations for business model and strategy	-				
4. Supervisory expectations for internal governance	-				
5. Supervisory expectations for risk management	**5.1. Risk management system**				
	5.2. Credit risk management				
	5.3. Operational risk management				
	5.4. Market risk management				
	5.5. Liquidity and funding risk management				

Section	Subsection	Description of bank's status	Bank's compliance status	Additional comments	# deficiency
	5.6. Scenario analysis and stress testing				
6. Supervisory expectations for disclosures	-				

54. When completing the table above, banks consider the following definitions for the information requested:

- **Section**: It makes reference to sections 3 to 6 from the Bank of Albania guideline/recommendations on climate-related and environmental risks. Not to be modified by banks.
- **Subsection**: The section makes reference, when applicable, to subsections of sections 3 to 6 above from the Bank of Albania guideline/ recommendations on climate-related and environmental risks. Not to be modified by banks.
- **Description of bank's status**: Banks are expected to include here a description of the current situation of the bank in relation to the compliance (on non-compliance), as well as any specific plan to be implemented in order to meet the recommendations set in each specific section or subsection as described in Bank of Albania guideline on climate-related and environmental risks.
- **Bank's compliance status**: A 3-level scale where banks are expected to show, in their opinion, their level of compliance in each specific section or subsection:

  - Compliant: the bank fully meets the expectations set in the Bank of Albania guideline regarding the specific section or subsection, or there are few low-relevant aspects to be improved and action plans are in force for the bank to be compliant in a very short period of time.
  - Weak: the bank partially meets the expectations set in the Bank of Albania guideline regarding a specific section or subsection, or the bank does not meet any of the expectations or recommendations and has in place action plans to meet them.
  - Non-compliant: the bank does not meet any of the expectations set in the Bank of Albania guideline regarding a specific section or subsection, and there is no action plan in force for the bank to be compliant or partially compliant in a very short period of time.

  Banks take into account that they will be expected to develop and implement actions for each of the deficiencies identified in this self-assessment".

- **Additional comments**: Any additional comment the bank may considered relevant to note regarding their status, actions to be implemented, any plan already under development or implementation, etc.
- **# deficiency**: A numerical identifier (i.e., 1, 2, 3, etc.) associated to a given deficiency that banks are expected to associate to a given deficiency. Different numerical identifier is expected to be associated to different deficiencies.

8.3 Annex 3. Action plan: template and instructions

55. This Annex provides banks with both a standardized template and instructions that banks follow to report the Bank of Albania with a follow-up of the status of the action plan described in paragraph 52.c) from this guideline:

# Action to be implemented	Description of the action to be implemented	# related deficiency(ies)	Complexity	Potential barriers	Expected deadline to be fully implemented	Implementation goals for the 1st year	Implementation goals for the 2nd year[7]	Implementation goals for >2 years[8]
...								

56. When completing the table above, banks consider the following definitions for the information requested:

[7] Only applicable in case the proposed action implementing time is longer than the referred timeframe.
[8] Only applicable in case the proposed action implementing time is longer than the referred timeframe.

- **# Action to be implemented**: A numerical identifier (i.e., 1, 2, 3, etc.) associated to a given action to be implemented by the bank in order to meet (either in the short or medium to long term) the recommendations from this guideline on climate-related and environmental risks. Different numerical identifiers are expected to be associated to different actions in order to be able to follow-up the evolution of actions along the annual reporting of the status by each bank to the Bank of Albania. Banks need to take into account that more than one action plans may be associated to a single deficiency identified in the previous self-assessment.
- **Description of the action to be implemented**: Banks are expected to include here a description of the action plan to be implemented to be compliant with the recommendations set in each specific section or subsection as described in this guideline on climate-related and environmental risks. Reference to areas involved, externalities, etc., are expected to be included by banks in the description.
- **# related deficiency(ies)**: Banks here include the identification number of all the deficiencies ("# deficiency") that a given action plan is expected to help to "fix". Banks may take into account that one action plan may be related (or be impacting) one or more deficiencies; and one or more deficiencies may be associated with a given action plan.
- **Complexity**: A 3-level scale where banks are expected to show, in their opinion, the level of complexity of a given action to be implemented, following the below scale:

    - **Low**: the bank expects the action to be implemented in a short period of time; a low volume of resources (i.e., staff, money, etc.) are to be dedicated for its implementation; and/or no critical decision needs to be taken at Steering Council or Shareholders Assembly level.
    - **Medium**: those cases not considered to be of a low nor high complexity.
    - **High**: the bank expects the action not to be implemented in a short or medium period of time; a high volume of resources (i.e., staff, money, etc.) are to be dedicated for its implementation; and/or critical decisions needs to be taken at Steering Council or Shareholders Assembly level.

- **Potential barriers**: Banks are expected to enumerate and briefly explain any potential barrier that might delay the implementation of the action. Banks also include any potential mitigation measures the bank is about to define or implement.
- **Expected deadline to be fully implemented**: Bank's expected deadline for a specific plan to be fully implemented. When reporting time frames instead of specific dates, banks are expected not to report time frames longer than 3 months (i.e., 1st quarter of 2025 may be considered valid).
- **Implementation goals for the 1st year**: Banks are expected to include here subdivisions of the global action plan that are expected to be implemented in the 12 months following the reporting date.

- **Implementation goals for the 2nd year**: In those cases where the implementation time is expected to last for more than 12 months, banks are expected to include here subdivisions of the global action plan that are expected to be implemented between 12 and 24 months following the reporting date.
- **Implementation goals for >2 years**: In those cases where the implementation time is expected to last for more than 24 months, banks are expected to include here subdivisions of the global action plan that are expected to be implemented starting from 24 months following the reporting date.

8.4 Annex 4. Action plan follow-up: template and instructions

57. This Annex provides banks with both a standardized template and instructions that banks follow to report the Bank of Albania with a follow-up of the status of the action plan described in paragraph 52.c) from this guideline:

# Action to be implemented	Implementation status (%)	Any changes made to the initial expected deadline to be fully implemented	Description of advances since the previous reporting status	Next steps to be implemented in the following 12 months	Additional comments
...					

58. When completing the table above, banks consider the following definitions for the information requested:

- **# Action to be implemented**: A numerical identifier (i.e., 1, 2, 3, etc.) associated to a given action to be implemented by the bank in order to meet (either in the short or medium to long term) the recommendations from the Bank of Albania guideline on climate-related and environmental risks. Different numerical identifiers are expected to be associated to different actions in order to be able to follow-up the evolution of actions along the annual reporting of the status by each bank to the Bank of Albania. Banks need to take into account that more than one action plans may be associated to a single deficiency identified in the previous self-assessment.
- **Implementation status (%)**: An estimation from the bank, of the time consumed, more granular sub-actions put in place, etc., over the total implementation needs for the action to be fully implemented. Values shall range between 0% and 100%.
- **Any changes made to the initial expected deadline to be fully implemented**: Banks are expected to point out here any change made (i.e., delays or advances) to the initially defined deadlines for the implementation of the specific action. An assessment on how any delay or advance may impact to overall completion of the action is also expected to be included.
- **Description of advances since the previous reporting status**: Banks are expected to include here any advance related to the implementation of the specific action since the previous status reporting. Banks include mentions, at least, on the "next steps to be implemented in the following 12 months" reported for the same activity in the previous action plan follow-up, or in the "implementation goals for the 1st year" category in case this is the first time that the bank submits the action plan follow-up.
- **Next steps to be implemented in the following 12 months**: Banks are expected to include here subdivisions of the global action plan that are expected to be implemented in the 12 months following the reporting date.
- **Additional comments**: Any additional comment the bank may considered relevant to note regarding the status of the implementation of the action plan, any potential barrier, meeting deadlines, modifications to the initial definition of a given action, etc.

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