



2021



# SUSTAINABILITY REPORT

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## Foreword by senior management

With the Paris Agreement, countries around the world have set a target of keeping global warming below 2° Celsius, and as close to 1.5° Celsius as possible. The Government of Iceland has signed and ratified the agreement, and it participates in the journey shared with the European Union and Norway, with the aim of reducing greenhouse gas emissions by 55% between 2019 and 2030. Furthermore, the Government of Iceland's objective is that Iceland shall be carbon-neutral by 2040.

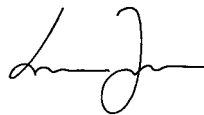
By law, the Government of Iceland, public institutions, and companies that are majority-owned by the Government must adopt a climate strategy with explicit targets for reduced greenhouse gas emissions and carbon neutralisation. The Central Bank of Iceland supports the Government's sustainability goals with its policy and legally mandated objectives, which enable the Bank to participate actively in Iceland's fulfilment of its international climate obligations.

Although the Government bears the primary responsibility for implementing strategies and ensuring funding for climate risk mitigation and systematic transition to a carbon-neutral economy, there are tasks within the Central Bank's purview that require the Bank's contribution. It is important that the Central Bank set a good example by moving its own activities and operations towards carbon neutrality. It is also within the Central Bank of Iceland's purview to identify, assess, and monitor risk factors and the impact of climate change on the resilience of the financial system and the economy more broadly.

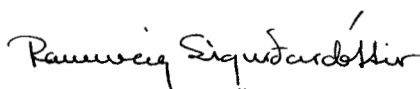
Climate change is one of the biggest challenges of our time, posing an existential threat to human welfare and prosperity. The impact of climate change on our natural environment, biota, and community, the unsustainable use of natural resources, and the transition to a carbon-neutral economy will put strain on the financial system and the economy as a whole. It is vital that the Central Bank of Iceland and other central banks respond decisively to these changes within their sphere of responsibility.



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Deputy Governor for Financial Supervision

# Introduction

The year 2021 was an eventful one for the Central Bank in terms of sustainability and climate issues. The Bank published its first environmental and climate policy, together with an action plan aimed at a 40% reduction in the Bank's carbon footprint by 2030 relative to 2019 levels. The strategy is in accordance with the precedent set by the Government Offices of Iceland and on the statutory authority found in the Act on Climate Change, no. 70/2012. The environmental and climate policy is supported by implementing the Green Steps programme and green accounting.

During the year, the Bank began participating in the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), which it had joined at the end of 2020. The Bank issued an Individual Pledge outlining its climate objectives in connection with the United Nations Climate Change Conference (COP26) in Glasgow in collaboration with other NGFS members.

The Bank organised a series of staff meetings focusing on how climate change and its repercussions relate to the Bank's activities. The Bank also initiated the establishment of a Nordic-Baltic central bank network where climate issues are discussed in a broad context. Furthermore, the Bank joined the non-governmental organisation *Festa – Center for Sustainability* and held meetings on climate issues with various external parties.

The Central Bank of Iceland is now publishing its first sustainability report and aims to issue it annually, in line with its goal of making further progress in the area of sustainability in coming years. The report will contain sustainability information from the Bank's operations, as well as describing how the Bank incorporates climate issues and sustainability into its core activities. It will also discuss how the Bank communicates information and supports the incorporation of sustainability into the activities of the entities it supervises.

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# Sustainability in Central Bank of Iceland operations 2021



## Environmental factors

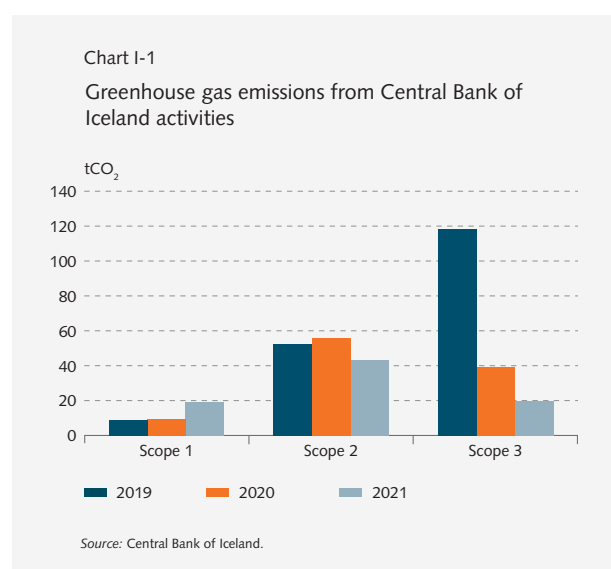
### Environmental and climate policy

The Central Bank of Iceland's new environmental and climate policy was published in May 2021, based on the precedent set by the Government (see Appendix I). The aim of the policy is to function as a guidepost for the Bank in its systematic reduction of greenhouse gas emissions, thereby enabling the Bank to participate actively in ensuring that Iceland fulfils its climate obligations. The Bank is committed to reducing the greenhouse gas emissions from its operations by 40% by 2030 relative to 2019 levels.

The Central Bank is a knowledge-based institution, and its employees' intelligence and skills are essential to its activities. The Bank stresses that employees maintain their knowledge and emphasises a work environment that encourages staff members to learn from one another. International trends and currents are important in the Bank's work, and the Bank cooperates with a number of international institutions in its field. Employee training takes place in part through interactions with the international scholarly and institutional community, including the International Monetary Fund (IMF), the Bank for International Settlements (BIS), European supervisory bodies, and Nordic central banks. International cooperation related travel has generated a large part of the Bank's carbon footprint in the past. The Bank aims to reduce travel without reducing international cooperation by establishing priority rankings for travel and by working together with partner institutions to increase the number of remote meetings where possible.

Greenhouse gas emissions from the Bank's activities fall into three categories, or scopes: direct emissions (Scope 1), indirect emissions due to energy use (Scope

2), and other indirect emissions (Scope 3). Chart 1 illustrates the Bank's emissions from 2019 through 2021 in each scope, and Table 1 contains a further breakdown of emissions components. The Bank's baseline carbon footprint year is 2019, which serves as the reference for the target. It should be noted that in 2019, the Financial Supervisory Authority had not yet merged with the Central Bank; therefore, the baseline is currently being updated to capture the 2019 carbon footprint of the two institutions combined. Further information on measurements of greenhouse gas emissions can be found in the section on green accounting.



In order to follow through on its environmental and climate policy, the Bank issued an action plan in November 2021, specifying measures that will contribute to the attainment of set targets. Examples of such measures include swapping out the Bank's motor

vehicles for electric cars, using only low-emission taxis, cutting back on air travel, and increasing recycling. The Bank's environmental committee is responsible for the environmental and climate policy, in consultation with the Governor. The targets laid out in the policy are ambitious, and it is important to achieve them. The environmental and climate policy and the action plan will be reviewed annually.

The Central Bank's offices are currently being renovated. The aim of the renovations is to place all of the Bank's employees under one roof and to enhance their well-being including through improved lighting, air quality, and acoustics. These improvements enable the merged institution to inhabit a building that in recent years has housed only the Central Bank.

The Bank's environmental and climate policy emphasises an eco-friendly procurement policy and the provision of education to staff members on environmental issues. In 2021, regular staff meetings were held on various topics relating to environmental and climate issues. Furthermore, a procurement procedure was established in order to guarantee transparency and ensure that the Bank's procurement practices support its environmental and climate objectives. The environmental and climate policy is supported by the adoption of the Green Steps programme and green accounting.

### Implementation of the Green Steps programme

The Green Steps programme is an initiative sponsored by the Environment Agency of Iceland with the aim of systemically reducing the environmental impact of Government institutions. The Bank has been successfully implementing the programme in its activities, although the pandemic certainly caused delays, as have the merger and the associated construction work.

The Bank launched a number of Green Steps-related projects in 2021. One of these was to request more environmentally responsible options from all of the Bank's largest suppliers. Single-use batteries have now been swapped out for rechargeable batteries on the Bank premises. Wasted food in cafeteria and catering activities is measured regularly, use of packaging has been reduced, and organic waste sorting is now an option on all floors in the building. Procedures for holding more environmentally responsible events have been issued, a contract providing for use of low-emission taxis where possible was made with a taxi service, and employees whose work for the Bank involves driving have been trained in eco-driving techniques.

### Green accounting

The Central Bank of Iceland practises green accounting and keeps track of its purchases and waste from the standpoint of environmental and climate targets. The Bank's carbon footprint is calculated from the results of its green accounting and the travel habit survey carried out annually among Bank staff members. A carbon footprint system that can also be used for green accounting is currently being implemented.

The Bank's carbon footprint is calculated using the *greenhouse gas protocol*.<sup>1</sup> Falling under Scope 1 are fuel purchases for both the Bank's motor vehicle fleet and other fossil fuel use. Scope 2 includes electricity and hot water use, and Scope 3 includes employees' work-related air travel and taxi use, employees' travel to and from work, and emissions due to waste disposal.

As can be seen in Table 1, the Central Bank's largest emissions categories are air travel and waste. As is mentioned above, central banks base a large share of their activities on dialogue and knowledge gathering, both domestically and internationally, in order to ensure, to the maximum extent possible, that their work reflects best practice and the most recent knowledge available. Furthermore, activities relating to financial stability and financial supervision are based largely on European regulations and standards issued by European supervisory and financial stability institutions, which are then implemented in Iceland. In addition, it is important for central banks to maintain connections with international businesses and institutions.

Table 1. GHG emissions, by scope, from the reference year (2019) through 2021

<i>Emissions expressed in tonnes of carbon dioxide equivalent (tCO<sub>2</sub>e)</i>	2019	2020	2021
Direct emissions (Scope 1)			
Driving, Central Bank vehicles	9.1	9.4	10.2
Other fuel use	0	0	9
Indirect emissions (Scope 2)			
Heat and electricity	52.6	55.8	43.4
Indirect emissions (Scope 3)			
Air travel	105.3	11.7	5.5
Taxis	1.6	0.4	0.03
Employee transportation	0.5	0.1	0.2
Waste	11.2	27	14.2

Air travel among Central Bank staff members declined markedly in 2020 and 2021, owing to the COVID-19 pandemic. An increase in air travel and the

1. The greenhouse gas protocol, or GHG protocol, is an internationally recognised accounting standard for greenhouse gas emissions: <https://ghgprotocol.org/>.

associated greenhouse gas emissions can be expected as the impact of the pandemic on travel tapers off. The Bank's environmental and climate policy assumes that the air travel-related carbon footprint will contract by 40% between 2019 and 2030. This objective will be supported by the largely COVID-induced shift towards remote meetings, which have shown their value. Waste-related emissions increased between 2019 and 2020, mainly because of construction work at the Bank beginning in 2020; however, this is a temporary situation.

### Series of informational meetings on climate issues

In connection with its environmental and climate objectives, the Central Bank places emphasis on educating its staff about climate issues. In 2021, the Bank organised a series of meetings for its staff, wherein Bank specialists gave presentations on various issues relating to climate and the Bank's areas of responsibility. The series of meetings has three aims: to draw attention to central banks' role in climate issues; to enhance staff members' knowledge of the impact of climate change on financial systems and economies; and to deepen knowledge

among the staff members who gave presentations. One presentation was held each month, on topics including climate targets in the Bank's internal operations, the environmental and climate policy, the related action plan, and the Green Steps programme in Government operations. Discussions also covered whether and how environmental and climate issues relate to the Bank's roles in financial supervision, financial stability, and monetary policy. The series is ongoing and, in 2022, will include presentations by outside experts engaged to enhance the knowledge of the Bank's specialists still further.

### Cooperation through the NGFS

In 2021, the Central Bank began participating in the *Network of Central Banks and Supervisors for Greening the Financial System (NGFS)*, which it joined at the end of 2020. The Bank had representatives in three of five NGFS workstreams during the year (for further information, see the Box on the NGFS). The Central Bank also participated in the NGFS annual meeting, and Bank experts participated in the publication of a report on the

## Box 1

### The NGFS

*The Network of Central Banks and Supervisors for Greening the Financial System (NGFS)* is a worldwide network of central banks and financial supervisors that have declared their willingness and commitment to working together to promote and develop best practices for managing climate- and environment-related risk in the financial sector and to promote sustainable and environmentally responsible investment. The NGFS is active in issuing publications and engaging in discourse on the topic. All of its publications can be found on its website.

The NGFS was established by eight central banks and financial supervisors in Paris in 2017, on the two-year anniversary of the Paris Convention (COP21). The number of central banks and financial supervisors that have joined the organisation has risen rapidly, and by the end of 2021 the NGFS had 100 members plus 16 auditing members. Member institutions participate directly in the organisation's activities, both through workstreams and by taking part in NGFS meetings, and can thereby keep abreast of the discussion taking place there and exert influence on discussions and policies. In 2021, the organisation's work comprised five so-called work-

streams, which focused on financial supervision, macro-financial issues, scaling up green finance, and climate-related data issues and research.

The NGFS issued a declaration in connection with the COP26 convention, held in Glasgow in November 2021, in which it pledged to step up its attempts to support the Paris Accord by bolstering the financial system's resilience against climate- and environment-related risks, as well as promoting green financial sectors and increased flows of capital towards a sustainable economy. There are a number of ways to achieve this goal. They include strengthening the collection, analysis, and dissemination of data on climate risk; improving climate scenarios; enhancing understanding of the interactions between monetary policy and climate risk; and promoting global harmonisation and greater capacity among NGFS members to address climate risk and make use of the advice the organisation provides. Working with the NGFS has proven very fruitful for central banks and financial supervisors, as the organisation has enabled cross-border mobilisation of experts, which is of particular benefit to smaller countries.



NGFS climate scenarios for central banks and financial supervisors. In connection with its participation in the NGFS, the Central Bank of Iceland has established an advisory group representing all of its departments, so as to follow up on and consider NGFS-related materials and discuss climate issues on central banks' agendas in a broader context. The advisory group is conceived as a catalyst for action to combat climate risk.

In November, the Bank issued an Individual Pledge in connection with the UN Climate Change Conference in Glasgow under the aegis of the NGFS, specifying its climate-related commitments, including a 40% reduction in its carbon footprint by 2030; the preparation of guidelines for use by supervised entities in identifying, assessing, and monitoring the climate risks that may exist on their balance sheets; and the inclusion of climate risk as an element in stress testing the financial system and financial market entities. The Individual Pledge can be found in its entirety in Appendix II.

## Social factors

### Central Bank employees

The Central Bank emphasises attracting and retaining reliable and committed staff members with wide-ranging expertise and experience who work together to achieve outstanding results, and it adheres to an ambitious human resources policy. The main priorities of the policy are: a strong sense of teamwork, responsible managers, respect and well-being, equal rights, knowledge, professionalism, and progressiveness. The Bank has taken various steps with these priorities in mind, including management training, renovation of the Bank premises, introduction of targeted training with new educational materials, and a series of climate meetings.

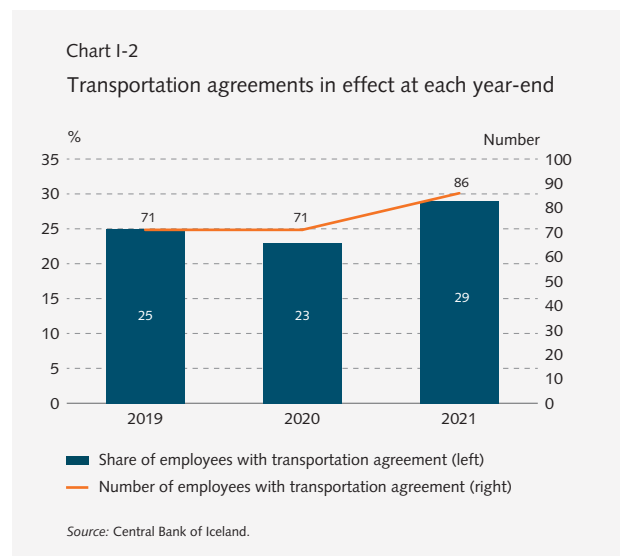
The Bank also stresses the mental and physical health of its employees. It has an active policy in place to combat workplace harassment and bullying, and it carries out regular employee satisfaction surveys. Furthermore, the Bank offers transportation agreements to encourage employees to walk or bike to work, as well as annual measurement of health metrics and access to a fitness centre in the building.

The pandemic made its mark on the Bank's 2021 operations in a variety of ways. On-site work declined markedly at the beginning of the pandemic, and later on the Bank gave employees greater flexibility to work from home as needed. Employees were assisted in setting up a home office and were provided with online training in good posture and in reducing physiological stress in the workplace.

During the year, it was decided that employees should continue to be offered the flexibility to work remotely part of the time. With these measures, the Bank wishes to ensure that the work environment is flexible and conducive to a healthy work-life balance. The Bank stresses cohesiveness and good health among its employees. It held a health initiative in October, encouraging staff members to engage in physical exercise 30 minutes per day for 30 days, offering measurement of health metrics, and providing health-related education. Furthermore, the Bank participated in the workplace competition called Lífshlaupið, a health-related incentive programme run by the Icelandic Sports and Olympic Federation, with 82% of staff members taking part.

The Central Bank's transportation policy encourages staff members to use public transport or other eco- and health-friendly modes of travel. The Bank's long-term goal is to increase the share of staff members who sign transportation agreements and to reduce total emissions from travel to and from work by 40% by 2030. These are ambitious targets, and the Bank intends to make a concerted effort to achieve them in coming years. Bank employees also have the option of various environmentally responsible transport options if the need arises during working hours, including electric cars and e-bikes. Furthermore, the Bank has contracted with Strætó, public transportation, to provide special terms for employees who travel by bus. The option of remote working also supports the Bank's effort to reduce emissions from staff members' travel to and from work.

At the end of 2021, 29% of employees had made transportation agreements with the Bank. Under these agreements, employees pledge to use environmentally responsible methods of transport to and from the workplace.



As is noted above, the Central Bank relies on the intelligence and expertise of its employees. Its policy is to maintain a staff with broad and diverse expertise and experience and to maintain a work environment that supports employees' initiative and desire to evolve and grow in their work and shoulder responsibility. Emphasis is placed on ensuring that employees keep their knowledge current and use it effectively in their work, thereby supporting the Bank's priorities. The Bank offers strong, diverse educational initiatives with a targeted needs analysis, an effective education and training plan, and regular assessments of the success of the initiatives. The work environment shall encourage sharing of knowledge among employees and shall foster their efforts to learn from one another.

During the year, the Bank began using an education and training system so as to offer employees a variety of courses, enhance their knowledge, and hone job development options within the Bank. The system keeps track of education and training events, thereby simplifying staff members' access to the educational options on offer. The training can take the form of third-party courses or courses developed in-house by Bank staff. These include an introductory course for new employees, which is offered to all staff members in order to present the Bank as a workplace and provide a range of useful information.

In 2021, the Bank embarked on a robust management training initiative for senior management, departmental directors, and heads of unit. The purpose of the programme was to build managers' skills and enhance their ability to set policy for the Bank as a whole. This includes implementing the Bank's values and vision, building up a strong and cohesive team, and strengthening cooperation across the organisation, with primary emphasis on leadership, teamwork, and change management.

### Equal rights at the Central Bank

The Central Bank makes an effort to promote equal rights, equal treatment, and respect for employees, and it adheres to a human resources policy in compliance with the Act on Gender Equality, no. 150/2020, and the Act on Equal Treatment in the Labour Market, no. 86/2018. In March 2021, the Bank reviewed its equal rights policy, which states, among other things, that the Bank shall make it easier for employees to harmonise their obligations towards their work and their family, that employees shall be treated equally in terms of hiring and professional advancement, and that no harassment of any kind will be tolerated within the Bank.

At the end of 2021, the Central Bank employed 294 members of staff, 151 males and 143 females.

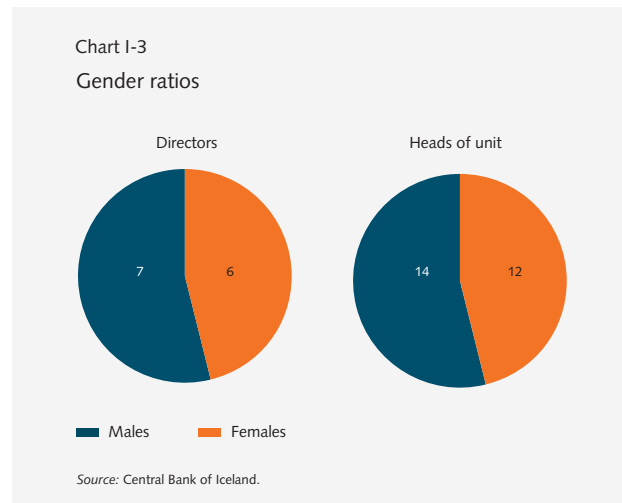


Table 2. Number of employees, by department, at year-end 2021

Department	Number	Male	Female
Banking	22	13	9
Governors	4	2	2
Finance	12	3	9
Financial Stability	28	20	8
Economics and Monetary Policy	24	13	11
Internal Audit	3	1	2
Compliance and Inspections	25	10	15
Pensions and Insurance	13	6	7
Human Resources	7	1	6
Markets and Business Conduct	16	10	6
Markets	32	17	15
Operations	35	12	23
General Secretariat	27	11	16
Information Technology and Statistics	46	32	14
Total	294	151	143

Operating within the Bank is an equal rights committee whose members are appointed for a term of three years. The committee meets regularly, and its role includes maintaining an overview of regulatory instruments on equal rights and equal treatment of employees, and ensuring compliance with them. It works on the renewal of the Bank's equal rights plan, monitors its implementation, and evaluates the validity of tips and pointers on equal rights and equal treatment of staff members.

At the beginning of 2019, the Central Bank was awarded equal pay certification, which was renewed for three years in autumn 2021. An equal pay analysis showed that there was no unexplained wage gap between genders at the time. Strong emphasis is placed on maintaining diversity among departmental directors,

and in October 2021 the Bank was awarded the Equality Scale. The Equality Scale is a dynamic project initiated by the Association of Businesswomen in Iceland (FKA) with the aim of equalising gender ratios in corporate management.

## Governance

### Values and code of conduct

Sound values and a clear vision are the foundation for building a strong culture and cohesive team across the Central Bank. The Bank has recently formulated a vision for the future and identified key values to be used as guideposts in its work: *integrity, decisiveness, humility, and professionalism*. These values form the foundation for the Bank's professional practices, enhance confidence in the Bank, and foster the achievement of the Bank's objectives.

The Bank takes pride in ensuring that its activities are consistent with ethical principles. It has adopted a code of conduct that is based on the Bank's core values and describes further the ethical values that employees must embrace and be guided by in their work. The code

of conduct, which is based on the Act on the Rights and Obligations of State Employees and the general code of conduct for State employees, covers topics such as connections and conflicts of interests, interactions in the workplace, and employees' work habits.

### Climate-related areas of responsibility

The Central Bank's governance practices will be shaped further with respect to climate issues and other matters relating to sustainability. The environmental committee, which answers to the Governor, formulates the climate policy and action plan and is responsible for implementing the Green Steps programme. The Governor has entrusted the Deputy Governor for Financial Stability with overseeing climate-related work. Among other things, the Deputy Governor directs the advisory group representing all of the Bank's departments, which is mentioned in the section on the NGFS. The advisory group shares information on central banks' and financial supervisors' climate-related work, as well as discussing information pertinent to the NGFS. The Deputy Governor for Financial Stability is also responsible for sharing information and building knowledge about cli-

## Box 2

### The TCFD

The global Financial Stability Board (FSB) led the way to the establishment of the *Task Force for Climate-Related Financial Disclosures (TCFD)* in December 2015, with the aim of identifying the types of information that investors, lenders, and insurers need in order to assess and price climate-related risks and opportunities. In 2017, the TCFD issued recommendations outlining how companies should disclose climate-related financial risks. The purposes of the recommendations are to increase transparency about firms' responses to climate-related risk and to serve as a tool for identifying such risk and taking it into account in financial decision-making.

The recommendations fall into four categories: governance, strategy, risk management, and metrics and targets. Companies and institutions use the recommendations to assess both their impact on the climate and the short- and long-term impact climate change will have on their operations, including risks and opportunities. The aim is for the recommendations to be recognised internationally

and used widely as a tool for companies and investors to project the impact of climate change, thereby fostering the allocation of capital to investments characterised by sustainability, resilience, and new solutions, opportunities, and business models.

The TCFD recommendations are widely in use and have become a part of organisations' annual reporting. Recommendations and legislation on sustainable information disclosure will increasingly be based on the TCFD recommendations.

The NGFS has published guidelines on central banks' publication of climate risk-related information, which are based on the TCFD recommendations and include scenarios based on various climate change-induced temperature increases. In 2022, the Central Bank is scheduled to begin preparing its own scenario analysis so as to assess climate risk using NGFS scenarios, and will publish climate-related information according to the NGFS recommendations thereafter.

mate issues, both within the Bank and outside it. The aim is that climate change and the associated risks, both physical risk and transition risk, will be discussed at the meetings of the Bank's policy committees – the Monetary Policy Committee, the Financial Stability Committee, and the Financial Supervision Committee – as circumstances require. Climate risk and the Bank's policy formulation in this area will also be discussed regularly by senior management.

### **Sustainability report**

The present publication is the Central Bank of Iceland's first *Sustainability Report*. With its release, the Bank aims to enhance transparency about its own climate- and sustainability-related actions and explain how it plays its role in supporting the Government's climate objectives over the period through 2040. The Central Bank is also dedicated to informing stakeholders, not least the general public in Iceland, about the Bank's role in climate issues and how it intends to achieve its own targets in this area. Furthermore, this report functions as an incentive for Bank employees, better enabling them to follow the Bank's performance in this area, which plays an important role in ensuring that the Bank meets its climate targets. The Bank plans to issue annually a report containing sustainability information and explaining how the Bank incorporates climate issues and sustainability into its core operations. In the future, the Bank plans to base its reports on, among other things, the recommendations from the *Task Force for Climate-Related Financial Disclosures (TCFD)*, which a number of central banks have already adopted.

# The Central Bank's climate-related obligations and the path forwards



## Departmental targets

The Bank's departments set their own climate- and sustainability-related targets in 2021 and presented them to the Governor early in 2022. The targets, which are both operational and professional, will be reviewed annually. Operational targets include supporting remote work, reducing travel, increasing the number of transportation agreements with employees, use of digital and cloud solutions, and emphasis on environment-friendly equipment (also in cooperation with merchants and service providers). Furthermore, the Bank is implementing a carbon footprint system that can also be used for green accounting. In addition, the Bank is planning improvements to its bicycle facilities and intends to apply for the Nordic Swan Ecolabel for its cafeteria and catering department. Professional targets centre mainly on acquiring knowledge and incorporating environmental and climate issues into the Bank's professional work, including through participation in work groups and various types of collaboration with other central banks and financial supervisors.

## The Central Bank of Iceland's Individual Pledge to COP26

In connection with COP26 in Glasgow, the Bank issued an Individual Pledge setting forth its climate-related obligations under the aegis of the NGFS. The obligations specified in the Bank's pledge fall into three categories, each of which is discussed more fully below:

1. To reduce the carbon footprint from the Bank's operations, in line with the Icelandic Government's climate targets.

2. To map the climate risk facing the Bank, the financial system, and the Icelandic economy.
3. To support an orderly transition to a low-carbon economy by actively exchanging opinions with stakeholders and by building up competency and knowledge in the field, both within the Bank and with outside stakeholders.

## I) The Bank's carbon footprint

The measures taken by the Bank with regard to its own operations are discussed above. The environmental and climate policy and the related action plan were published in 2021 and cover the period through 2030. The Bank is currently engaged in mapping its entire carbon footprint and reviewing the merged institution's data for 2019, so as to ensure a thorough analysis of the carbon footprint and the most accurate year-on-year comparison possible.

## II) Mapping climate risk

Assessing the climate risk facing the Central Bank, the financial system, and Icelandic society begins with dialogue with key experts in the field. In 2021, the Bank discussed the topic with various entities, including Government ministries, universities, public institutions, and other stakeholders and experts.

Climate change poses a threat to financial stability. Poor harvests, catch failures, damage to buildings and structures, and loss of human life as a result of climate change could have a colossal impact on the economy as a whole. Furthermore, financial stability could be jeopardised by economic and societal changes associated

with the transition to a low-carbon future, including regulatory amendments, carbon taxes, and changes in people's behaviour. Scenario analyses are used to better assess the potential impact of climate change on financial stability. The Central Bank aims to publish its first climate risk scenario analysis before the end of 2022. For further information, see the Box on climate risk.

The Central Bank will base its analysis on scenarios issued by the NGFS; however, it has also begun to cooperate with Icelandic institutions that have expertise in climate issues, such as the Iceland Meteorological Office, the Institute for Sustainability Studies and the Institute of Economic Studies at the University of Iceland, and Icelandic Natural Catastrophe insurance in order to adapt its physical risk scenarios to actual Icelandic conditions. The scenario analysis draws on the experience of other countries and international institutions that have issued such analyses in the recent term. The preparation of

scenario analyses is an important element in identifying and assessing the risks posed to financial stability as a result of climate change, but it can also contribute to systematic adaptation or transition by shedding light on and raising awareness of the magnitude of the problem.

Climate risk is also related to the application of macroprudential tools. The European Banking Authority (EBA), for instance, analyses whether and how climate risk should be incorporated into decisions on the application of such tools.

In 2017-2018, regulations pertaining to the European supervisory bodies were amended to increase the emphasis on climate and sustainability. Climate risk will play a more important role in supervision of financial activities in coming years, alongside amendments to European legislation. A bill of legislation on sustainability-related disclosures in the financial services sector and a taxonomy on sustainable investment is set to enter into

## Box 3

### Climate risk

Central banks promote price stability and financial stability, thereby supporting sustainable output growth and general well-being. Considering and responding to risks in the economy that could jeopardise these goals is part of central banks' activities, and climate risk is no exception. Climate change is only one type of systemic change that could affect the financial sector. In general, climate risk falls into two categories – physical risk and transition risk – and to an extent, physical risk diminishes as transition risk increases. It is important that policy making be transparent so that the transition to carbon neutrality will be as systematic as possible, thereby reducing the risks attached.

#### Physical risk

*Physical risk* refers to risks relating to increased frequency and magnitude of changes in climate (such as heat waves, landslides, floods, forest fires, and storms) and the long-term impact of climate change on the Earth's ecosystem (i.e., changes in rainfall patterns, rising average temperatures, rising sea levels, and acidification of the ocean).

Climate risk accumulates over a long period of time, and for quite a while it has been foreseen that the greatest damage would occur outside central banks' conventional time horizons. Monetary policy generally has a horizon of two to three years, while for financial stability it can range up to a decade. However, the repercussions of climate change have started to come palpably to the fore within these timeframes. If responses to climate change occur at the pace needed to reach set targets, they will require substantial systemic changes, which will invariably entail considerable risk. This risk must be considered and responded to appropriately, and in this area central banks have a role to play.

#### Transition risk

*Transition risk* refers to the risks accompanying the transition to a low-carbon economy. Greenhouse gas emissions must ultimately be neutralised in full in order to prevent further climate change. This process, which includes energy transition, is likely to have a strong impact on the economy, and therefore on the value of financial assets. Adopting carefully crafted measures is important, as a sudden, disorderly transition could have an adverse effect on financial stability and the economy more generally.



force in Iceland on 1 January 2023, subject to passage by Parliament at the autumn legislative session. The EU's *Regulation on sustainability-related disclosures in the financial services sector (SFDR)* provides for financial market participants' disclosure of information on how their activities take account of environmental, social, and governance (ESG) factors. The EU's *Taxonomy Regulation* establishes a classification system that provides criteria for the determination of whether businesses' activities satisfy the requirements for designation as environmentally sustainable.

The Central Bank will make an effort to engage in active dialogue with supervised entities and provide guidance to them on how to identify, assess, and monitor the climate risks on their balance sheets and how to account for climate risk in their internal risk assessments (ICAAP for banks, ORSA for insurance firms, and ORA for pension funds). At the same time, climate risk and ESG criteria will be a part of the annual supervisory review and evaluation process (SREP for banks, SRP for insurance firms, and PSRP for pension funds).

### III) Transition relating to climate change

The Central Bank prioritises cooperation with other knowledge institutions and stakeholders, including the general public, on the nature and impact of climate change and its implications for Icelandic society. The Bank commits to sharing with financial firms and other authorities the climate-related knowledge it acquires through experience, expertise, and international collaboration so as to enable them to scale up their work on climate-related issues more effectively. As has previously been stated, the Bank met in 2021 with domestic stakeholders in the area of climate issues and climate risk. It plans to organise regular symposia on the topic together with financial market entities, as it is vital to engage in regular dialogue on the rapid changes ahead and the new requirements that will be made of financial institutions in coming years. The Bank also has high hopes for its cooperation with other institutions and businesses through the Festa – Center for Sustainability, which it joined during the year.

One of the Bank's first tasks in building up knowledge of the impact of climate risk on the financial sector was to join the NGFS, which is discussed further in a Box in this report. The NGFS is an important forum for the Central Bank to keep abreast of the rapid developments currently taking place in its professional

sphere. The Bank will make use of NGFS training material to provide its employees with the necessary skills and knowledge of climate-related risks, with a view to efficient implementation of relevant NGFS recommendations.

The Bank initiated regular consultation among the Nordic-Baltic central banks concerning their work on climate issues and climate change in a broad sense, and these institutions also hold regular meetings in various other venues. Furthermore, Bank staff members have written articles and given presentations in order to increase knowledge of the climate risks facing the Icelandic economy, as can be seen in the documents accompanying this report. The Bank has used its expertise to prepare green bond issues by participating in the creation of a sustainable financing framework for the Government. The framework was launched in September 2021. As regards the Central Bank's balance sheet, minimum standards will be put in place for the incorporation of climate risk into reserve management policies and practices.

# Appendix I

## The Central Bank's environmental and climate policy

### Purpose and objectives

The Central Bank of Iceland has adopted a climate policy for the period through 2030, following the precedent set by the Government. In its operations, the Bank shall endeavour to set an example in its approach to climate issues. The Bank pledges to reduce greenhouse gas emissions by 40% between 2019 and 2030, based on data from green accounting and travel habit surveys. From 2021 onwards, the Bank's operations shall be carbon-neutral, and the Bank will support domestic carbon sequestration projects commensurate with its year-2020 emissions.

The Bank's policy extends to all of its departments, including the buildings it uses and construction carried out on its behalf. The aim of the policy is to enable the Bank systematically to reduce greenhouse gas emissions from its own activities, thereby setting a positive example and enabling it to participate actively in ensuring that Iceland fulfils its international climate obligations.

### Key priorities

Concurrent with carbon neutrality from 2021 onwards, the Central Bank will reduce its greenhouse gas emissions by 40% from 2019 through 2030, with emphasis on the following:

- Employee air travel
- Operation of Central Bank vehicles and use of taxis
- Employee transportation to and from work
- Use of other fossil fuels
- Use of heat and electricity
- Waste sorting
- Procurement
- Active education and provision of information to employees on environmental and climate issues

### Vision for 2030

The Central Bank has reduced its greenhouse gas emissions by 40% relative to 2019. Bank employees are aware of the importance of environmental and climate issues and participate actively in implementing the Bank's climate policy. The Bank is actively involved in international collaboration on the topic and shares information with the general public and other stakeholders concerning the state of climate issues, the risks associated with climate change, and how to respond to them. The Bank

has been carbon-neutral for 10 years and has offset its carbon emissions with certified units since 2021.

### Follow-up

The environmental committee is responsible for the Bank's environmental and climate policy, in consultation with the Governor. All Central Bank employees are responsible for implementing the climate policy so that the Bank can contribute to reducing greenhouse gas emissions. Green accounts shall be submitted to the Environment and Food Agency by 1 April each year. The policy will be reviewed by the environmental committee once a year, progress made in actions and targets will be evaluated, and recommendations for improvements will be made based on year-on-year developments in greenhouse gas emissions.



## Appendix II

### The Central Bank of Iceland's Individual Pledge to COP26

As a member of the Network for Greening the Financial System (NGFS), the Central Bank of Iceland is pleased to announce its support of the network's declaration to the 26th annual UN Climate Conference (COP26).

The Central Bank of Iceland commits to uniting around the goal of a more sustainable planet. Climate change is the biggest challenge of our time, posing an existential threat to human welfare and prosperity. Climate risks, including the risks inherent in a transition to a carbon-neutral economy, present substantial challenges for the management of the economy and the financial system. No responsible actor can sit idly by.

While it is governments that are primarily responsible both for implementing policy and committing resources to the mitigation of climate risks and for facilitating an orderly transition to carbon neutrality, there are areas where central banks can and must contribute. It is of the utmost importance that central banks respect their mandate and act responsibly in the face of a threat of this enormity.

Understanding the potential risks and impact of climate change on the macro-economy and on the resilience of the financial system falls within central banks' purview and responsibilities. Likewise, it is important that any central bank demonstrate leadership in moving its own operations and activities towards carbon neutrality.

The Central Bank of Iceland commits to the following:

- The Bank commits to achieving carbon neutrality in its own operations, starting a determined process in that direction in 2021. The Bank has also set a goal of a 40 percent carbon footprint reduction by 2030, so as to support the Icelandic Government in meeting its international climate commitments. An action plan to achieve this goal will be published as part of the Bank's 2022 Annual Report, and the progress made in meeting the commitments will be communicated publicly each year.
- The Bank will introduce supervisory guidance for its supervised entities, with the aim of effectively identifying, measuring, and monitoring the climate risks to which they are exposed. The Bank will work with financial institutions to better understand climate risks to the financial

system and the wider economy, both physical risks and those related to a transition to a net-zero economy.

- The Bank commits to including climate risk in the stress testing of the financial system and financial market participants, based on NGFS scenarios. The Bank will use the results to raise awareness among financial market participants and other stakeholders about the potential impact of climate risk on financial stability.
- The Bank will develop minimum standards for the incorporation of climate risks into its reserve management policies and practices.
- The Bank commits to sharing with financial firms and other authorities the climate-related knowledge it acquires through experience, expertise, and international collaboration so as to enable them to scale up their climate work more effectively.
- The Bank will make use of NGFS training material to provide its employees with the necessary skills and knowledge of climate-related risks, with a view to efficient implementation of relevant NGFS recommendations.

# Accompanying documents

Kalkofninn: [Central banks have a role to play in climate issues](#)

Kalkofninn: [Scenario analyses relating to climate risk](#)

Presentation by Deputy Governor at a symposium of the Scientific Committee on Climate Issues

The Central Bank of Iceland's [Individual Pledge to COP26](#)

Central Bank of Iceland [Annual Report 2021](#)

Scenarios in Action: [A progress report on global supervisory and central bank climate scenario exercises](#)



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