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Growing Asia's Markets

7 August 2020

By online submission

The Monetary Authority of Singapore
https://eservices.mas.gov.sg/survey/se/0DE6A2EA5077CFF2

ASIFMA Response to The Monetary Authority of Singapore's Consultation Paper on Proposed Guidelines on Environmental Risk Management (Banks)

Question 1. MAS seeks comments on the entities and business activities that are in the proposed scope of the Guidelines.

The Asia Securities Industry & Financial Markets Association ("ASIFMA") and its members welcome the invitation to respond to the consultation paper issued by the Monetary Authority of Singapore ("MAS") on "Proposed Guidelines on Environmental Risk Management (Banks)" ("Consultation Paper"). ASIFMA's Asset Management Group ("AAMG") will provide its views separately in relation to the MAS' consultation paper on "Proposed Guidelines on Environmental Risk Management (Asset Managers)."

In March this year, ASIFMA published its whitepaper on sustainable finance – *Sustainable Finance in Asia Pacific: Regulatory State of Play ("State of Play Whitepaper") (See https://www.asifma.org/wp-content/uploads/2020/03/sustainable-finance-in-asia-pacific.pdf)* – which provides an overview of regulatory developments and frameworks adopted to date in major Asia Pacific jurisdictions and on a global scale. In particular, within the paper, ASIFMA strongly encourages policymakers in the Asia Pacific jurisdiction to coordinate with each other and apply the following principles:

- avoid requirements that are unduly complex or prescriptive, whilst being aware of unintended consequences of regulation such as market distortion and fragmentation;

- strive for consistency and compatibility whilst allowing flexibility for the variation of economic and capital markets development, a key feature of the Asia Pacific region;

- where possible, align policies and frameworks with international standards to avoid unnecessary complexity and unlevel playing field issues for market participants operating globally; and

- where standards are not yet under development, seek to encourage and catalyse development of such standards, particularly as Asia Pacific jurisdictions have unique perspectives in not only being significant recipients of sustainable finance, but also being most impacted by sustainability challenges.

We also highlighted key industry concerns within the paper, which in summary, are as follows:

- the need for a consistent and representative taxonomy which is developed upon a common global framework of taxonomy, whilst ensuring flexibility for regional specificities;

- the need for a coherent and harmonised disclosure framework to have available reliable data for ensuring transparency and comparability between sustainability metrics throughout the economy;

- the need for a common approach to prudential risk assessment and stress testing; and

- the need for policymakers and regulators to be mindful of overly prescriptive policy measures which risk stifling market-led initiatives that have supported the development of sustainable finance to date.

We hope that the ASIFMA State of Play Whitepaper provides useful insight to MAS as we believe it important that policymakers and regulators take these points into consideration in light of the complex and multidimensional nature of this issue, and susceptibility to cross-jurisdictional problems.

Specifically in relation to the proposed scope under Question 1, the industry welcomes a proportionate application of the Guidelines, recognising that banks vary in size and nature of business activities, and that the implementation of the Guidelines would be in a way that is commensurate with the size and nature of each bank's activities, as well as its risk profile.

We note that the business activities of "extending credit to corporate customers, underwriting capital market transactions" would already fall within most banks' risk management frameworks. We would however, discourage labelling of any products or transactions to be of a certain risk profile due solely to it being compliant or non-compliant with ESG or sustainability frameworks, as this may otherwise affect the banks' own internal profiling and risk management policies.

Our members feel that it would be helpful if MAS could also provide further clarity or specify examples of “other activities which expose it to material environmental risks”, as stated in section 1.1 of the Guidelines.

Furthermore, we would suggest that business activities with non-material environmental risk be excluded from the guideline requirements, subject to adequate periodic review, as our members feel this would allow entities in scope to better focus resources on business activities with material environmental risk.

Governance and Strategy

Question 2. MAS seeks comments on the proposed responsibilities of the Board in overseeing environmental risk management, including its role in ensuring that environmental risk, where material, is addressed in the bank's risk appetite framework.

The industry recognises the Board's share of responsibilities in identifying and managing environmental risk and addressing the challenges of climate change. We also recognise that the role of the Board and senior management in overseeing environmental risk management is aligned with the existing oversight responsibilities of the Board.

In relation to the proposed responsibilities of the Board, ASIFMA would like to seek clarification on the following:

- whether oversight of environmental risk management, specifically with respect to non-Singapore incorporated entities, can be done by global supervision based on its global framework, with Singapore-based arrangements made to consider the Singapore-centric aspects; and

- whether section 3.4 of the Guidelines may be clarified to permit for delegation to one or more sub-committees.

We would also suggest section 3.3(c) of the Guidelines be amended so that it refers to the requirement by the Board to designate specific roles and responsibilities of individuals at senior management level to deal with environmental risk, instead of the current wording which relate to the roles and responsibilities of the Board and senior management.

Question 3. MAS seeks comments on the proposed responsibilities of senior management in overseeing environmental risk management, including its role in developing an environmental risk management framework and policies, regularly reviewing their effectiveness, and allocating adequate resources to manage environmental risk.

On the proposed responsibilities of senior management, our members agree with the approach outlined in section 3.4 and appreciate that the responsibilities are set out are in descriptive, rather than prescriptive form.

Question 4: MAS seeks comments on the proposal for banks to designate a senior management member or a committee to oversee environmental risk, where such risk is material.

The industry agrees with this proposal, particularly noting that this would only be applicable where risks are material.

ASIFMA would like to seek clarification on the following:

- whether the internal committee or appointed individual approving transactions with higher environmental risk as proposed in section 4.4 of the Guidelines can be the same senior management member or committee that oversees environmental risk mentioned in section 4.2 of the Guidelines;

- whether such senior management member is required to be from the local offices in Singapore, or whether this person may be someone at the global offices. This is in reference to the fact (as also noted in section 1.2 of the Guidelines) that "*[a] bank should implement the Guidelines in a way that is commensurate with its size and nature of its activities as well as its risk profile*"; and

- how such requirements and responsibilities fit with the Individual Accountability Guidelines (which MAS consulted on previously).

Risk Management

Question 5: MAS seeks comments on the expectation for banks to engage each customer that poses higher environmental risk to improve its risk profile and support its transition towards sustainable business practices.

Some of our members have raised concerns in relation to section 4.4 of the Consultation Paper which states: "*The bank should also engage each customer that poses higher risk, to improve its* *environmental risk profile, and support its transition towards sustainable business practices..."*

Our members feel that if this were to be a regulatory requirement, it may impose banks to be more akin to an environmental regulator of corporations rather than just a *"force for good,"* as contemplated by the Guidelines and stated in section 2.4 of the Consultation Paper.

Most of our members note that banks are already engaged increasingly with customers on environmental risks as a result of both the banks' own risk management frameworks, and in response to changing commercial drivers for customers. Thus, it should not be necessary for MAS to impose on the banks mandatory obligations to engage with customers. In particular, there are concerns that the due diligence involved for purposes of assessing each customer on whether or not it poses a higher environmental risk to improving its risk profit and supporting its transition towards sustainable business practice (which may in practice, involve conducting a direct dialogue with the customer, setting of conditions, monitoring such customer's performance) would be substantively resource intensive. In that regard, we would recommend that banks be given discretion to focus on those cases where engagement is most likely to result in a positive outcome, particularly in high risk sectors. This may be a function of the bank's leverage over the particular customer, the customer's willingness to prevent or mitigate the environmental impact, and the materiality of the environmental impact. In a similar vein, our members would also like to request flexibility to define and manage exposures, as we consider the requirement to conduct engagement with any higher risk client to improve their environmental risk profile to be too broad.

ASIFMA would like to seek clarification on the following:

- whilst this question states that banks are to engage each customer "that poses higher environmental risks", the drafting in section 4.4 of the Guidelines states *"[a]t the customer level, MAS proposes for the banks to undertake an environmental risk assessment of each customer as part of its assessment process for credit facilities or capital market transactions, particularly for sectors with higher environmental risks".* ASIFMA seeks clarification as to whether the order of assessment would be to first do an assessment on each customer's environmental risk profile, generally based on the relevant sector in which the client operates, and then to subsequently engage the customers that pose higher environmental risks. This approach would enable banks to direct appropriate and focused resources on such customers;

- whether MAS would be able to provide general guidelines or parameters on what it expects banks to do to improve the customer's environmental risk profile and support its transition towards sustainable business practices, for example, whether there would be a requirement for banks to have a certain level of expertise in the sustainable finance field before engaging with corporations on this aspect; and

- in relation to the customer review for environmental risk, whether MAS would consider excluding client level monitoring and/or engagement on environmental risk if a business activity or a portfolio has been identified as having non-material environmental risk, or if an industry or sector has generally been identified to pose limited environmental risks. For some banks, it is worth noting that business lines (e.g. custody services) are more middle-back office processing in nature, and the environmental impact from the services provided to clients may not be directly apparent.

Overall, our members acknowledge and are supportive of the role that banks have to play in raising the customers' awareness about environmental risks and in supporting the customers' transition towards sustainable business practices, such as low-carbon and climate-resilient business activities. However, we are also cognisant of the importance of appropriate framework conditions for companies in the "real economy," and recognize that the financial sector is only one part of the sustainability equation. In this regard, we strongly encourage MAS to work with other agencies and regulators to apply environmental risk management regulations and frameworks and disclosure requirements across other sectors in which banks' customers operate, so that there can be a more consistent and coherent implementation of policies in managing environmental risks and developing sustainable business practices.

Furthermore, we suggest that MAS focus on enabling the ESG data ecosystem on the back of support for clear, comparable, and detailed ESG disclosure guidelines. The focus needs to be on getting companies to provide environmental and climate change information, as addressing the problem of lack of information is most critical for progress. Regulators may subsequently consider at a future stage to partner with other agencies and regulators to support the set-up of a common, free and publicly accessible environmental and climate change database with companies' ESG information. The accessibility and transparency of ESG information would promote awareness amongst banks and corporates and facilitate the making of financial decisions for economic returns. Nevertheless, we note that a database is only as good as the data able to be obtained.

Question 6. MAS seeks feedback on the expectation for banks to develop tools and metrics to monitor and assess their exposures to environmental risk, and examples of the aforementioned tools and metrics that may be adopted.

The industry acknowledges and agrees with the expectations in the Guidelines for management and monitoring environmental risk.

ASIFMA would highlight however, that MAS must also be aware of the certain inherent challenges in developing tools and metrics, and in assessing each bank's exposures to environmental risks, which include the following:

- *Development of tools and methodologies is still at a nascent stage*: the development of appropriate environmental risk management framework and policies is dependent on the preceding condition that the senior management be equipped with tools and methodologies for measuring, disclosing and managing wider environmental risks factors. However at present, the development of such tools and methodologies are still at a nascent stage, largely due to the unavailability of quality data for certain environmental risks, and the lack of consistent and widely applied standards for measuring and disclosing biodiversity risks and universally accepted indicators for biodiversity impacts;

- *Availability of reliable data*: The Guidelines also include climate risk change, for which data availability and reliability is lacking, and this together with the lack of historical data, amongst others, have also brought about challenges in forward-looking climate risks modelling. We would therefore request that MAS give due weight to the lack of climate related data when coming up with its guidelines, and also consider collaborating with other regulators to support the use of a common database for climate related risks, with consistent criteria, definitions and common reporting and data management standards. We believe this would aid in the continued development and the comparability of metrics for banks.

Given the above challenges, ASIFMA would also further request that MAS be mindful of overly prescriptive policy measures. As we have noted in our *State of Play Whitepaper* (see section 2.4 of https://www.asifma.org/wp-content/uploads/2020/03/sustainable-finance-in-asia-pacific.pdf for details), global financial institutions would typically align their sustainability practices to industry developed frameworks and best practices which can be valuable in ensuring consistency in a market where consistent global regulatory and supervisory approaches have yet to be developed. This would provide due flexibility for the shifts and variations that come about as markets mature.

We would also like to emphasise that scenario analyses and stress tests are particularly important in the management of environmental related risks. However, these should only be limited to physical and transition-related risks (rather than reputational risks, as it may be difficult to quantify such risks which would vary from institution to institution).

Question 7. MAS seeks comments on whether there are specific aspects of environmental risk management policies and processes that would benefit from further supervisory guidance.

We set out some examples as below which would benefit from further supervisory guidance:

- environmental and climate related data (or minimum standards) that banks should require corporate clients to disclose (including data from corporate clients);

- environmental and climate related metrics that banks should look towards assessing and in turn, what banks would be required to disclose; and

- setting out benchmarks for environmental risks and giving examples of key climate scenarios which could be used for risk management purposes.

ASIFMA would like to seek clarification on the reference data sources which would be in the quantification of metrics for environmental and climate change risk assessment.

We would like to further highlight that the development of metrics would require reliable and consistent data. However, as noted in our State of Play Whitepaper (See section 2.2 of https://www.asifma.org/wp-content/uploads/2020/03/sustainable-finance-in-asia-pacific.pdf), ESG data is difficult to obtain for reasons outlined therewithin. MAS may then have to ensure that data required for use in the metrics be easily obtainable, possibly through the imposition on banks' customers to provide the necessary information to banks, rather than having banks require the customers provide it to them by contractual means.

The industry would like to suggest that MAS provide case studies and detailed examples of tools, methodologies and metrics to aid implementation.

We reiterate that the tools and metrics at present, are at a nascent stage and still developing as markets evolve and the landscape continues to shape itself, in the area of environmental and climate change risks. As such, we request that MAS take into consideration the fact that a specific set of tools and metrics adopted now may be less relevant or appropriate in the future.

We note that the maturity level of methodologies and tools / metrics to monitor and assess broader environmental risks beyond climate risks (such as biodiversity risk, water consumption, or pollution risk) are much less developed compared to that of climate risks – as such, the industry believes these aspects would benefit from further supervisory guidance, and regulatory expectations on the management and disclosure of these areas of risk should reflect this imbalance.

Specifically, in the area of third-party providers of sustainability tools, we note that the market is expanding quickly, and in a rather inconsistent manner, while there exists a high level of competition in the ESG ratings space. As users of these ratings may find such market landscape confusing to navigate, we recommend that standards in relation to due diligence, transparency, and conflict of interest should be put forward to avoid unintended consequences.

Disclosure

Question 8. MAS seeks comments on the proposed form and frequency of disclosure of environmental risk by a bank.

The industry believes that the disclosure framework should be aligned with international standards and we appreciate MAS' recognition of finding reliance on group level disclosures to be appropriate. We are therefore supportive of MAS' recommendation to take reference from international reporting frameworks including the Financial Stability Board's Task Force on Climate-related Financial Disclosures.

As to the form of disclosure, for banks listed in Singapore, we would recommend that the timing and the form of disclosure be aligned with the sustainability reporting requirement already in place. The same approach can be taken for banks listed in other markets, to reduce duplication of work and information, but be balanced with the considerations of transparency and sufficiency of details for regulatory purposes.

Given the evolutionary nature of the Guidelines, we would also expect that the Guidelines will continue to align and converge with global standards over time.

Lastly, our members believe that the following areas should remain at the discretion of each individual bank:

- where the proposed disclosure of climate and environmental risks should be made or filed (*see the "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures" on TCFD's recommendation that preparers of climate-related financial disclosures provide such disclosures in their mainstream (ie. public) annual financial filings*); and

- at which structural level of a customer's organisation such disclosure should be made (*see for example, section 4.1.3 of HKMA White Paper on Green and Sustainable Banking, where group practice can be referred to if that applies to HK operations, and the SGX Sustainability Reporting Guideline also set out requirements for group and investment holding company reporting*).

General

Question 9. MAS seeks comments on any aspects of the Guidelines that have not been covered in earlier questions.

Currently, scenario-analysis and stress testing methodologies are still underway for capturing the broader environmental risks beyond climate-related risks. We encourage further work to be conducted in this context to better understand potential transmission channels, interlinkages with climate risks, and to develop globally aligned environmental risk scenarios. We suggest MAS consider an ongoing programme of guidance and communication across all financial institutions to provide appropriate guidance as approaches to this area develop. In addition, a cross agency approach with other regulatory bodies in Singapore may help ensure consistency, and aid the development of a comprehensive and consistent framework for Singapore's sustainable finance ecosystem, providing a stronger basis for implementation.

The industry requests clarity on the definition of terms such as "green" and "material" (for example, reference may be made to the SGX-ST Sustainability Reporting Guide on the definition of "materiality" and the methodology used to determine it), and clarity in relation to the taxonomy used, and in this regard, we encourage MAS to take into consideration currently existing international and regional taxonomies to allow for harmonised implementation by international banks or banks with international customer bases.

We also seek clarification on the consequences of non-compliance with the Guidelines, and query whether there should be any legal implications in these early stages, of transitioning to a sustainable finance landscape in the Singapore.

We note that MAS has stated in paragraph 2.5 of the Consultation Paper that MAS is working closely with other financial supervisors at international forums, including the Network of Central Banks and Supervisors for Greening the Financial System (“NGFS”) and the Sustainable Insurance Forum, to strengthen the financial system's resilience to environmental risk, and notes that best practices for supervisors, banks and financial institutions to manage the impact of environmental risk are currently being developed at the international level. We look forward to further details from MAS on how the Guidelines would reflect the harmonisation of risk management standard of banks and financial institutions in relation to these international best practices that are underway.

In relation to section 4.5 of the Guidelines stating that *"[t]ransactions with higher environmental risk should be subject to the bank’s enhanced due diligence, which may include site visits to the customer and separate review by in-house or external personnel with environmental risk expertise"*, our members would like to emphasise that on-site visits or third party reviews should be considered in situations where the bank provides a service that is directly linked to the actual ESG labelled project / impact, for example, in the context of project finance, and should not be considered as a standard requirement for any transaction with higher environmental risk.

As a next step, we would like to further encourage MAS to develop an overall policy roadmap outlining the following areas:

- the regulator's intentions with respect to ESG and sustainable finance related regulations and policies (for example, by setting out its plans for a standardised taxonomy, establishing data standards, harmonising disclosure requirements, setting standards for ESG ratings agencies, capacity building including training programs and subsidies for knowledge building); and

- details of other efforts to nudge the key players to jump start a green finance market (see for example, developments in the region such as Hong Kong Exchange’s STAGE platform https://www.hkex.com.hk/eng/stage/index.htm) and to link the Singapore markets to other global and regional markets on the ESG and sustainable finance front).

This would enable market participants to have a better understanding of MAS' policy intentions, and further enable banks to more efficiently prepare for the implementation of the future regulatory framework in these aspects.

Implementation Approach

Question 10. MAS requests for examples of sound risk management practices currently implemented by banks, which would meet the expectations in the Guidelines.

We have listed below several examples of sound risk management practices currently being implemented by our member banks (See also the HKMA circular issued on 7 July 2020 on "Range of practices for management of climate risks" and the relevant Annex and the practices of "more advanced AIs"):

- A member bank has set up a Group-wide Climate Risk Strategy (CRS), sponsored by the Chief Risk Officer, for the implementation of the Task Force on Climate-related Financial Disclosures (TCFD) programme while at the same time supporting customers by financing and/or advising on the transition of their businesses towards low-carbon operations, technologies, products and services. The CRS is governed by a senior Steering Committee with senior management representation from five business divisions, as well as from the General Counsel, Compliance and Risk functions and the Impact Advisory and Finance department. The Committee oversees the management of climate-related risks across the bank;

- A member bank has identified sensitive sectors that pose greater environmental and social risks (including impacts to the climate) and has developed policies and guidelines to govern the responsible provision of financial services to clients within these sectors. The bank's internal specialist unit, Sustainability Affairs, evaluates whether a particular client's activities are consistent with the relevant industry standards and whether the transaction is compatible with its policies and guidelines for sensitive sectors. Based on the outcome of this analysis, the Sustainability Affairs submits its findings to a Reputational Risk Approver who is a senior manager independent from the area of business in question, or to the respective Reputational Risk Committees. They have the authority to approve, reject or impose conditions on our participation in a transaction or the establishment of a client relationship. In cases of particularly complex or cross-divisional transactions, the decision may be referred to the Position & Client Risk (PCR) cycle of the Capital Allocation & Risk Management Committee (CARMC). The PCR cycle of CARMC, chaired by the Group's Chief Risk Officer, is the most senior governing body responsible for the oversight and active discussion of reputational risks and sustainability issues (including climate change); and

- as a participant in the Paris Agreement Capital Transition Assessment (PACTA), a member bank is currently working with the think tank 2° Investing Initiative (2°ii) and 17 other international banks to develop and test methodologies for measuring the alignment of corporate lending portfolios with the Paris Agreement.

We would also like to mention that through a comparative analysis of the proposed regulatory requirements of key regulators in this region (notably MAS and HKMA) which has been prepared with the help of Ernst & Young, an ASIFMA member firm, our members generally observe the two jurisdictions' sets of regulatory expectations to be closely aligned (though wording and ordering may differ in parts), and are largely in line with what is expected of a good risk management system for environmental risk. As the majority of ASIFMA's membership and their clients operate globally and regionally between Singapore and Hong Kong as their major operating hubs in APAC, we underscore the criticality to ensure that wide divergence does not occur between the regulatory frameworks and standards across the region. We would be keen, in this regard, to share this comparative table with MAS to serve as a useful reference, and as a supplement to our submission. Please ask us if you wish to receive a copy of our analysis.

Question 11. MAS seeks comments on the proposed implementation approach, including the proposed transition period of 12 months.

The industry is generally supportive of the proposed implementation approach, but would strongly encourage that the Guidelines take into consideration the following:

- reflect international reporting standards, namely the TCFD's recommendations and the EU Non-Financial Reporting Directive, and disclosure obligations on banks and non-bank corporates are aligned (given that the disclosure obligations of banks are interlinked with the information obtained by the banks' customers);

- the implementation be done in phases, to take into account the lack of availability of data, tools and metrics for integration of environmental and climate risks and other risk quantification methodologies. We would like to request an overall policy roadmap to be developed on what may be expected at different phases (including MAS' expectations on banks during and after the implementation period with respect to the adoption of the guidelines); and

- the implementation timeline to take into account expected timelines in other key jurisdictions to ensure a consistent implementation process as many of our members are also subject to regulations in other jurisdictions that may be more complex and take longer to be finalised. This would also ensure unintended consequences, such as unlevel playing fields, are mitigated.

In relation to the proposed transition period, we ask that MAS consider extending the transition period to 18 months, after taking into account the implementation timeline of similar regulations in other jurisdictions (e.g. EU, Hong Kong, etc.), and as such, we would like to suggest a phased-in implementation period to be aligned to mid-2022. We also believe it would be helpful if MAS is more explicit about its expectations of banks during and after the implementation period with respect to the adoption of the guidelines, especially given that the industry may not be ready to achieve a complete implementation of the guidelines for the reasons laid out in our response to Question 6.

ASIFMA would like to thank MAS for considering our comments. We look forward to further engaging with MAS on these issues going forward, and remain at your disposal in the development of the proposed Guidelines, and also on future work in relation to addressing climate change and the development of a more green and sustainable financial market ecosystem. (*This submission was prepared with the assistance of the law firm Rajah & Tann Singapore LLP, an ASIFMA member, based on feedback from the wider ASIFMA membership.)*