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Growing Asia's Markets

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BY E-MAIL

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Dear Encik See Thuan Eu and Encik Nik Faris Nik Sallahuddin,

ASIFMA Response to BNM's Exposure Draft to Climate Risk Management and Scenario Analysis

The Asia Securities Industry and Financial Markets Association ("ASIFMA")[1], on behalf of its members ("the Industry") appreciates the opportunity to provide feedback on the Exposure Draft to Climate Risk Management and Scenario Analysis ("the Draft") from Bank Negara Malaysia ("BNM"). ASIFMA welcomes this draft guidance which reflects BNM's leadership and commitment towards climate and environmental risk management and efforts to align with internationally agreed approaches.

General Comments

ASIFMA especially commends the alignment BNM has achieved between the Draft and principles laid out by the Task Force on Climate-related Financial Disclosure ("TCFD"). We strongly support such convergence as we believe the harmonisation of prudential and supervisory principles globally is critical for enabling best practices across the international financial system and minimising fragmentation.

We also support BNM's overall level of alignment with the Basel Committee on Banking Supervision ("BCBS")'s proposed principles on climate risk, while offering further proposed amendments in the detailed analysis that follows to further reflect these principles. Also included in the detailed analysis are some requests for more guidance, including in relation to how climate-related financial risks should be incorporated in traditional credit risk models, and a number of clarifications that might benefit the final draft.

[1] ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

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ASIFMA also seeks further clarity regarding BNM's expectations for local operations of foreign banks. We assume that BNM is open to locally incorporated financial institutions and branches of foreign financial institutions meeting a material part of BNM's climate related requirements though compliance at the Group level. We advocate for materiality and proportionality to be taken into consideration to avoid unnecessary duplication of supervisory exercises.

Overall, ASIFMA welcomes BNM's phased approach which allows time for banks to establish relevant capabilities, and we also appreciate the level of detail and practical case studies provided as part of the Draft to illustrate expected implementation by the industry.

Finally, we draw your attention to the response from the Global Financial Markets Association ("GFMA") and the International Swaps and Derivatives Association ("ISDA") to BCBS's consultation on its Principles for the Effective Management and Supervision of Climate-related Financial Risks. We believe that harmonised and coordinated supervisory standards and practices are critical to drive climate-related financial risk management efforts and welcome BNM's guidance in this regard.

Detailed Analysis

We support BNM's overall level of alignment with the Basel Committee on Banking Supervision ("BCBS")'s proposed principles on climate risk, while offering the following proposed amendments to further reflect these principles, as well as to seek further guidance on some issues such as expectations regarding use of risk models and foreign banks' local operations.

- **Climate-related Financial Risk and General Risk Management:** We ask BNM to align the Draft's Principle 5 more closely with the BCBS proposed principles. Paragraph 10.2 requires banks to "clearly address climate-related risks within the risk appetite statement". The BCBS proposed principles are more flexible and would require banks to "adequately identify, monitor and manage all material climate-related financial risks as part of their assessments of banks' risk appetite and risk management frameworks." The BCBS language recognises that climate risk is a transversal risk that may manifest in any one or more of the risk types that banks have traditionally managed on a dedicated basis, such as credit, liquidity, operational, and legal risk. We propose the final BNM Principles affirm that climate-driven risks may be incorporated into and addressed through a bank's existing risk management governance program if the bank determines that this is the most effective means of risk management. Introducing a supervisory expectation that banks treat climate risk as a standalone risk type may limit banks' flexibility to integrate climate-related financial risk into existing risk management.

- **Climate-related Financial Risk Management *vis-à-vis* Capital Planning**: In relation to Paragraphs 10.2 and 11.3, we note that any expectation that banks incorporate climate-related financial risk into their capital planning processes at this time would be inappropriate in light of the need for further maturation of the relevant quantitative tools. As BCBS recently determined, there is limited research and accompanying data that explore how climate-related financial risks feed into the traditional risks faced by banks.[2] Given data gaps and the evolution of climate and risk transmission models, banks are generally in the data-collection and risk-identification- and-measurement stage of risk management.

[2] See Basel Committee on Banking Supervision, Climate-related financial risks – measurement methodologies (April 2021), 17-18, https://www.bis.org/bcbs/publ/d518.pdf.

- **Quantitative Limits and Thresholds:** We suggest use of quantitative limits and thresholds for climate-related financial risk as a risk management tool is premature for many financial institutions. Banks should be permitted initially to use their directional analysis to develop and inform their risk appetite and risk management frameworks prior to assessing whether any limits and thresholds would be appropriate. Requiring the imposition of limits before they have been properly tested will likely have unintended consequences on bank lending and credit accessibility.

- **Progressive Development of Risk Capability:** Paragraph 11.7(b) would require banks to "compute climate-related metrics, such as GHG emissions (comprising own emissions and financed emissions) and translate these metrics into financial impact to develop climate-related risk metrics." We would encourage closer alignment with the BCBS proposed principles, which require banks to "start building risk analysis capabilities by identifying relevant climate-related risk drivers that may materially impair their financial condition, developing key risk indicators and metrics to quantify exposures to these risks, and assessing the links between climate-related financial risks and traditional financial risk types such as credit and liquidity risks." This would better recognise the evolving nature and understanding of climate-related financial risks and the fact that existing data and tools to measure and quantify climate-related financial risk—and in particular, longer-term physical and transition risks—are only just emerging, and will need to undergo substantial exploration, refinement, and adaptation over time. Although data capabilities are improving, significant gaps in data sourcing, capture, standardisation, and aggregation substantially affect the accuracy of projections and risk assessment.

- **Credit Policies and Due Diligence:** Paragraph 11.7(e) would require banks to "enhance the existing due diligence policy and process to adequately identify and evaluate climate-related risks at the inception of a contractual relationship and on an on-going basis, at the portfolio, counterparty and transaction levels." We recommend clarifying that this sub-paragraph relates to credit risk and align this statement with BCBS Principle 8, Paragraph 32, which states that "Banks should have clearly articulated credit policies and processes to address material climate-related credit risks. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate the impacts of material climate-related risk drivers on their credit risk profiles (including counterparty credit risk) on a timely basis. Banks should incorporate consideration of material climate-related financial risks into the entire credit life cycle, including client due diligence as part of the onboarding process and ongoing monitoring of clients' risk profiles."

- **Taxonomy *vis-à-vis* Climate Risk:** Principle 10, Paragraph 11.14 in the Draft refers to greenwashing of a bank's portfolio and refers to standards and taxonomies. Taxonomies generally define a "sustainable" or "green" economic activity, but do not measure climate risk. We would recommend removing this paragraph from the Draft.

- **Climate-Risk Materiality:** In Principle 12, on climate scenario analysis, we ask BNM to clarify that Paragraph 12.4 refers to "material" climate-related financial risks, as follows: "In response to outcomes from the scenario analysis, financial institutions shall develop management actions to mitigate the impact from ***material*** climate-related risks."

- **Incorporation into Credit Risk Models:** ASIFMA welcomes further guidance on how climate-related financial risks should be incorporated in traditional credit risk models such as probability of default (PD), loss given default (LGD), and exposure at default (EAD). We also believe that regulatory credit estimates should be tested for robustness against climate risk; this should include parameters based on through-the-cycle and downturn methodologies.

- **Terminology:** We would recommend BNM to refer to "climate-related *financial* risks" in lieu of "climate-related risks" in alignment with BCBS.

ASIFMA appreciates your consideration of our comments, and we welcome any further discussion with your department. In the meantime, if you have questions, please contact me (mchan@asifma.org) or Christine Terng, Associate, Policy and Sustainable Finance (cterng@asifma.org).

Sincerely,

Matthew Chan
Managing Director, Head of Policy and Sustainable Finance at
Asia Securities Industry and Financial Markets Association (ASIFMA)