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MAS Issues Environmental Risk Management Guidelines for Banks, Insurers and Asset Managers

Introduction

On 8 December 2020, the Monetary Authority of Singapore ("**MAS**") issued three sets of Guidelines on Environmental Risk Management (collectively, "**Guidelines**") that apply to the following entities (collectively, "**FIs**"):

(i) banks, merchant banks and finance companies;
(ii) insurers; and
(iii) fund management companies and real estate investment trust ("**REIT**") managers.

The Guidelines set out sound practices for FIs in the following key areas:

- Governance and strategy;
- Risk management;
- Disclosure of environmental risk information;
- Underwriting and investment (for Insurers only); and
- Research and portfolio construction, portfolio risk management, stewardship and disclosure obligations (for Asset Managers only).

Each set of Guidelines is tailored to each sector based on its business activities and risk management practices. The FIs are given a transitional period to implement the Guidelines **within 18 months from 8 December 2020**.

The Guidelines follow from MAS' earlier consultations on the drafts of each of the Guidelines from 25 June 2020 to 7 August 2020. For a summary of the issues discussed in the MAS consultation papers, please refer to our previous Update titled "*MAS Consults on Environmental Risk Management Guidelines for Banks, Insurers and Asset Managers*", available here. MAS has also issued Responses to Feedback received on the earlier consultation papers ("**Responses**") on 8 December 2020.

This Update provides an overview of the Guidelines highlighting the scope of application and a summary of the salient features of the Guidelines for FIs to note, along with some practice insights.

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Scope of Application

Banks, merchant banks, finance companies

The Guidelines will apply to all banks, merchant banks and finance companies licensed/approved under Singapore laws (collectively, "**Banks**") in respect of the following activities:

- extension of credit to corporate customers;
- underwriting for capital market transactions. In its Response, MAS clarified that "capital market transactions" refer to Banks' debt and equity capital market activities; and
- other activities that expose Banks to material environmental risk.

Banks with material investment activities should refer to the relevant sections of the Guidelines for Asset Managers, for sound practices on the management of environmental risk with respect to investments.

Insurers

The Guidelines will apply to all insurers in Singapore, including insurers carrying on business in Singapore under a foreign insurer scheme established under the Singapore Insurance Act (collectively, "**Insurers**") in respect of the following activities:

- underwriting;
- investment; and
- other activities that expose Insurers to material environmental risk.

Asset Managers

The Guidelines will apply to:

- holders of a capital markets services licence for fund management ("**LFMC**") and real estate investment trust management ("**REIT**"); and
- registered fund management companies registered ("**RFMC**") under the Securities and Futures (Licensing and Conduct of Business) Regulations ("**SF(LCB)R**"),

which exercise discretionary authority over the investments of the funds/mandates that they are managing (collectively, "**Asset Managers**").

In terms of scope, the Guidelines are expressed to be generally applicable to Asset Managers who exercise discretionary authority over the investments of the funds or mandates managed by such Asset Managers. A question may be raised as to the applicability of the Guidelines on private equity / venture

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capital Asset Managers whose role may not - strictly speaking - involve the exercise of discretionary authority in investments. We believe that the expectations of the Guidelines will also apply in this instance, although the scope of the environmental risk management framework will need to take into account factors that are appropriate to the strategy and asset class managed by the manager.

MAS has also clarified in the Responses that the Guidelines will apply to Asset Managers who employ a passive investment strategy (for example Asset Managers whose strategy involves adopting partial replication methodologies or enhanced index strategies). Asset Managers in this category can take into account the size and nature of the mandate to implement its environmental risk management framework that is appropriate in passive rule-based investments.

Where Asset Managers delegate the investment management functions to sub-managers or advisors, the Asset Managers retain overall responsibility for environmental risk management. The Asset Managers are nevertheless expected to convey the expectations to the sub-managers or advisors and implement appropriate processes and procedures to assess and monitor the sub-managers' or sub-advisors' compliance with the expectations set by the Asset Managers.

Governance and Strategy

All FIs

The board of directors ("**Board**") and senior management of an FI are expected to incorporate environmental considerations into the FI's risk management framework, strategies, business plans and product offerings (where applicable). In this regard, FIs could take guidance from ongoing industry and international efforts, including the Network for Greening the Financial System (NGFS) concerning good environmental risk management practices. The Guidelines set out in detail the responsibilities of the Board and senior management of a Bank, Insurer and Asset Manager respectively.

Asset Managers

Presently, the statutory obligation for LFMCs and RFMCs to implement a risk management framework to identify, address and monitor the risks associated with customers' assets managed by the Asset Managers, in a manner commensurate with the nature, scale and complexity of the assets, is codified in the SF(LCB)R.

The Guidelines clarify the Board's and senior management's role in overseeing the integration of environmental risk management into the Asset Manager's investment risk management framework.

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Risk Management

All FIs

The Guidelines emphasise the need for FIs to develop a risk management framework and put in place robust policies and processes to manage environmental risks. Banks and Insurers will have to identify, assess and monitor material environmental risk and to mitigate its exposure to such material environmental risk, at both a customer and portfolio level, and for Asset Managers at an individual investment and/or portfolio level.

Set out below is a summary of some key matters that Banks, Insurers and Asset Managers are expected to adopt as part of their environmental risk management framework.

Banks

- **Customer risk assessment:** Banks should undertake an environmental risk assessment of each customer as part of their assessment process for credit facilities or capital markets transactions, particularly for sectors with higher environmental risk. The Guidelines set out qualitative criteria to assist Banks in identifying higher risk sectors; the Association of Banks in Singapore Guidelines on Responsible Financing includes a list of industries with elevated environmental, social and governance risks that Banks can take reference from. Banks should develop sector-specific policies, to articulate their respective expectations towards customers in sectors with higher environmental risk. MAS's approach is not to prescribe guidance on higher-risk sectors or Banks' financing policies towards these sectors at this stage.

  For transactions with higher environmental risk, Banks should develop sector-specific policies, undertake enhanced due diligence and, where applicable, escalate to an internal committee or appointed individual for approval. In addition, Banks should, on an ongoing basis, engage each customer that poses higher risk and encourage each of their transition towards sustainable business practices. The Guidelines set out that Banks may calibrate the extent of customer engagement based on factors including the materiality of the risk, the customer relationship and the customer's willingness and ability to improve its environmental risk profile, and the availability of alternative options to effectively mitigate the Bank's exposures to environmental risk. The Guidelines also provide a range of mitigating options for Banks in dealing with customers that do not manage their environmental risks adequately.

- **Portfolio exposures:** Banks should develop quantitative and qualitative tools and metrics to monitor and assess their exposures to environmental risk at the portfolio level. Further, Banks should develop capabilities in scenario analysis and stress testing to assess the impact of environmental risk on their risk profile and business strategies, and explore their resilience to financial losses under a range of outcomes.

Insurers

- **Enterprise risk management**: Insurers are already required under MAS Notice 126 (Enterprise Risk Management for Insurers) to have in place an enterprise risk management (ERM) framework which provides for the identification and quantification of relevant and material risks. Such risks should include environmental risks.

- **Customer risk assessment:** Similar to Banks and to address potential reputational risks, Insurers should undertake an environmental risk assessment of each customer as part of their assessment process, particularly for sectors with higher environmental risk. For transactions/customers with higher environmental risk, Insurers should undertake enhanced due diligence and where applicable, escalate to an internal committee or appointed individual for approval. Insurers should also develop sector-specific policies to engage each customer with higher environmental risk to improve its environmental risk profile and its transition towards sustainable business practices.

- **Underwriting process:** Insurers should incorporate environmental risk considerations into their underwriting process, taking into account the Insurers' overall risk management framework and risk appetite. They should also develop quantitative and qualitative tools and metrics to assess its underwriting exposures to environmental risk, where material.

  For an existing customer who does not manage the environmental risk adequately, Insurers should implement various measures to mitigate the risk, for example, pricing in the additional risk, applying limits on underwriting exposure, or reassessing the relationship with the customer, which may include exiting the relationship. For customers that are assessed to have a higher environmental risk profile, the Guidelines recommend that Insurers undertake certain escalation and monitoring processes to measure and manage the impact of environmental risk on their business.

- **Investment portfolio risk assessment:** Insurers must implement appropriate processes and systems to monitor, assess and manage the potential and actual impact of environmental risk in their investment portfolios on an ongoing basis. In addition, an Insurer must consider the impact of environmental risk on its investment portfolio under various stress scenarios and time factors.

Asset Managers

- **Research and portfolio construction:** Asset Managers should evaluate the potential impact of material environmental risk on an investment's return potential profile when carrying out research and portfolio construction, by applying appropriate tools and metrics to identify sectors with higher

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environmental risk and develop sector-specific guidance for higher risk sectors to aid their investment personnel in understanding their attendant environmental issues. In their assessment, Asset Managers should consider both transition and physical risks on an individual asset and portfolio level and take reference from international standards and frameworks, for instance the Global Reporting Initiative, CDP (formerly the Carbon Disclosure Project), the Sustainable Accounting Standards Board and Task-Force on Climate-related Financial Disclosure.

- **Portfolio risk management:** Asset Managers should implement appropriate processes and systems to monitor, assess and manage the potential and actual impact of material environmental risk on individual investments and portfolios on an ongoing basis. In addition, Asset Managers must develop capabilities in scenario analysis to evaluate portfolio resilience and valuation under different environmental risk scenarios. Where data may be limited, Asset Managers are expected to consider qualitative assessments and engage investee companies to adopt practices and frameworks of disclosure that will identify the most relevant risks and opportunities specific to their businesses.

- **Stewardship in investee company:** Asset Managers are expected to exercise sound stewardship and maintain proper documentation when implementing steps that seek to shape positive corporate behaviour and to manage environmental risk associated with investee companies through engagement, proxy voting and sector collaboration. For Asset Managers that manage real estate investments, they should consider putting in place asset enhancement initiatives, for instance measures to improve energy efficiency or waste management.

Disclosure

All FIs

Banks, Insurers and Asset Managers should make regular and meaningful disclosure of salient environmental risks applicable to their business. In this regard, the FIs should take reference from international reporting frameworks, including the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), to guide their environmental risk disclosures. Disclosures may be consolidated at the group or head office level.

It is proposed that Banks and Insurers should make environmental risk disclosures, minimally on an annual basis. All FIs are expected to regularly review their disclosure to improve its comprehensiveness, clarity and relevance, taking into account generally accepted measurement practices and methodologies.

Disclosure must include the FIs' approach to managing environmental risk and the potential impact of material environmental risk on Banks or Insurers and, in the case of Asset Managers, to their customers.

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Disclosure of the potential impact of material environmental risk should include quantitative metrics such as exposures to sectors with higher environmental risk.

Implementation Timeline

The FIs are given a transitional period of **18 months from 8 December 2020** to implement the Guidelines. By the end of the transition period, FIs are expected to apply the Guidelines to both existing and new products and/or transactions.

Although the Guidelines are expressed to have an implementation date of 18 months from the date of its issuance, MAS clarified in the Responses that in relation to Asset Managers, the regulatory expectation is to implement the Guidelines as soon as possible and in phases where practicable. The regulator is expected to start engaging the larger Asset Managers on implementation progress from Q2 2021.

FIs should also strive to make their first disclosure as soon as practicable after the Guidelines have been issued and within the transition period. Where applicable, the first disclosure should be made in an FI's next annual report/sustainability report after the 18-month transition period and posted on its website immediately after the 18-month transition period.

Practice Insights

Banks

The Guidelines set out MAS' expectation on financial institutions in governance, strategy, risk management and disclosure of environmental risk, and is in step with MAS' Green Finance Action Plan for Singapore to becoming a hub for green finance. The Guidelines show the regulator's emphasis on building resilience in the financial sector against environmental risks and its acknowledgment that the financial sector has a role to play in progressing environmental change. At the same time, the measured approach in the Guidelines do indicate that regulators have considered the challenges which may be faced by financial institutions in influencing customers' behaviour and the suggested environmental risk management practices featured in the Guidelines are therefore illustrative and not prescriptive or exhaustive.

The Guidelines go hand in hand with the Green and Sustainability-Linked Loan Grant Scheme rolled out in November 2020 which seeks to support corporates to obtain green and sustainable financing by providing grants to defray the expenses of engaging independent service providers in the validation of the green and sustainability credentials of the loan. With such regulations and grants in place, we expect to see more green and sustainable financing flows in the coming year and more importantly, improved environmental and sustainability consciousness amongst financial institution and corporates.

Asset Managers

Governance

The Guidelines set out MAS' regulatory expectations on the standards on environmental risk management and is complementary to the Guidelines on Individual Accountability and Conduct ("**IAC Guidelines**"). Accordingly, as Asset Managers formulate, apply and adopt environmental risk management policies within its business, it is important to take into account the expectations of the Guidelines that deal with the broad environmental risk management matters whilst fulfilling the requirements under the IAC Guidelines (including the designation of senior management or committee to oversee environmental risks, with clear and appropriate reporting and accountability outcomes).

Disclosure

The Guidelines do not prescribe the metrics and approach in which an Asset Manager manages environmental risk be disclosed to its clients. In view that environmental risk management practices and disclosure approaches are expected to continue to evolve and the manifestation of environmental risks differs as amongst managers depending on the strategy, nature / scope of the investment mandate and nature of the product offering, our recommendation is for the Asset Managers to build on a set of baseline disclosures relating to an Asset Manager's environmental risk approach (which may take into account prevailing industry reporting standards) and then build up the disclosures over time as the strategy, portfolio and disclosure standards evolve. MAS has clarified in the Responses that the disclosure may be made in an Asset Manager's annual report, sustainability report, investor report and/or website, with the regulatory standard of disclosure to be to strive to provide clear, meaningful and timely information.

It is heartening to note that the regulatory approach to implementation of the Guidelines is to do so in a manner that is commensurate with the scale and nature of the activities undertaken by Asset Managers, which will allow Asset Managers to formulate its policy and approach to environmental risk management in a manner which is measured and which takes into account the evolving risk assessment landscape.

Insurers

Environmental risk is increasingly recognised as a key global risk and growing environmental pressures are also disrupting economic activities. Not only does enviromental risk give rise to reputational concerns, it also may have financial impact on Insurers. Apart from the direct financial impact due to increase in number of claims and underwriting losses (for example, an increase in property and casualty losses caused by natural catastrophe events), Insurers may find themselves exposed to a decline in valuation and increased volatility in their investments (particularly, in sectors which have or are perceived to have cotribnuted to environmental degradation.

The Guidelines serve as a timely reminder to Insurers to join the concerted action by the financial sector to address the impact of environmental risk and support a smooth transition to an environmentally sustainable economy. The Guidelines will hopefully be the first step towards building resilence against the impact of environmental risks and Insurers becoming a "*force for good*". The implementation of the Guidelines is also in line with the establishment of the Global-Asia Insurance Partnership (a tripartite partnership between the global insurance industry, regulators and academia) – a platform which was launched recently to address systemic structural protection gaps and new emerging risks in insurance, with an initial focus on risks brought on by climate change (an issue which has plagued the industry for some time).

If you wish to find out more about how the Guidelines may affect your business operations or require assistance implementing the requirements under the Guidelines, please feel free to contact our team members below who will be happy to assist.

Further Information

Banks

- MAS Response to Consultation Paper on Proposed Guidelines on Environmental Risk Management for Banks
- MAS Guidelines on Environmental Risk Management for Banks dated 8 December 2020

Insurers

- MAS Response to Consultation Paper on Proposed Guidelines on Environmental Risk Management for Insurers
- MAS Guidelines on Environmental Risk Management for Insurers dated 8 December 2020

Asset Managers

- MAS Response to Consultation Paper on Proposed Guidelines on Environmental Risk Management for Asset Managers
- MAS Guidelines on Environmental Risk Management for Asset Managers dated 8 December 2020

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