MAS CONSULTS ON ENVIRONMENTAL RISK MANAGEMENT GUIDELINES FOR FINANCIAL INSTITUTIONS

On 25 June 2020 the Monetary Authority of Singapore (MAS) issued a set of three consultation papers on its proposed Guidelines on Environmental Risk Management (Guidelines) for asset managers, insurers and banks. The Guidelines aim to enhance financial institutions' (FIs') resilience to environmental risk, and strengthen the financial sector's role in supporting the transition to an environmentally sustainable economy, in Singapore and in the region.

This is part of MAS' Green Finance Action Plan to become a leading global centre for green finance.

The Guidelines were co-created with FIs and industry associations, and set out MAS' supervisory expectations for banks, insurers and asset managers in their governance, risk management, and disclosure of environmental risk.

Governance
Boards and senior management of FIs are expected to incorporate environmental considerations into their strategies, business plans, and product offerings and maintain effective oversight of the management of environmental risk.

Risk Management
FIs should put in place policies and processes to assess, monitor and manage environmental risk.

Disclosure
FIs should make regular and meaningful disclosure of their environmental risks, so as to enhance market discipline by investors.

The Guidelines aim to serve as a call to action for FIs to help drive the transition to an environmentally sustainable economy by enhancing the integration of environmental risk considerations in FIs' financing and investment decisions, and promoting new opportunities for green financing.

MAS' Supervisory Approach to Environmental Risk

Environmental risk is increasingly recognised as a key global risk, with climate change at the forefront of these concerns. The Intergovernmental Panel on Climate Change estimates that continued carbon emission, in line with historical rates, would likely lead to global warming of 1.5°C between 2030 and 2052. This would increase the probability of pervasive and irreversible impact for people and ecosystems. Growing environmental pressures are also disrupting economic activities and human well-being. For example, there has been a significant rate of decline in biodiversity worldwide, alongside a significant alteration of three-quarters of the land and more than 60% of the marine environment, which are caused by human actions.

At the national level, tackling climate change is a key priority, as it poses an existential challenge for Singapore. Singapore is doing its part to support a low-carbon future,

including through its enhanced 2030 Nationally Determined Contribution to the Paris Agreement and its Long-Term Low Emissions Development Strategy.

MAS also work closely with other financial supervisors at international forums to strengthen the financial system's resilience to environmental risk. For example, the Central Banks and Supervisors Network for Greening the Financial System ("NGFS"), and the Sustainable Insurance Forum ("SIF") are developing best practices for supervisors and FIs to manage the impact of environmental risk.

The International Organization of Securities Commissions has also established a Task Force on Sustainable Finance with a similar aim of addressing issues concerning sustainability-related disclosures and investor protection.

Environmental, physical and transition risks

Environmental risks, including climate change, loss of biodiversity, pollution and changes in land use, pose potential financial impact on FIs' portfolios and activities through physical and transition risk channels. Physical risk arises from the impact of weather events and long-term or widespread environmental changes. This can impair the collateral value of bank loans and revenue generating assets of investee companies, and lead to significant insurance claims.

Transition risk arises from the process of adjustment to an environmentally sustainable economy, including changes in public policies, disruptive technological developments, and shifts in consumer and investor preferences. For example, loans and investments in carbon-intensive sectors can be impaired, as the profitability of these businesses is impacted in the transition to a low-carbon economy.

Asset Manager Guidelines Scope

MAS propose to apply the Guidelines to:

(a) Holders of a capital markets licence for fund management ("LFMC") and real estate investment trust management ("REIT"); and

(b) Registered fund management companies ("RFMC"), which are registered under paragraph 5(1)(i) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations (Rg. 10)[i].

MAS recognise that the scale, scope and business models of asset managers and the investment strategies that they employ can be different. An asset manager should implement these Guidelines in a way that is commensurate with the size and nature of its activities, including the investment focus and strategy of its funds (including REITs) and segregated mandates (hereinafter collectively referred to as "funds/mandates").

MAS is also cognisant that asset managers may be appointed different roles (for instance as an investment manager, sub-manager or advisor) in the management of a fund/mandate. The Guidelines would generally be applicable to asset managers that have discretionary authority over the investments of the funds/mandates that they are managing. Conversely, for asset managers that do not have discretionary authority over the investments of the funds/mandates, the Guidelines would not apply.

For the avoidance of doubt, the Guidelines are not intended to prohibit or restrict asset managers from complying with and discharging their fiduciary duties and other legal obligations to their customers.

Asset Manager Guidelines – Overview

Governance and Strategy

The Board and senior management play critical roles in determining the asset manager's strategies, business plans and product offerings. Regulations 13(B)(1)(a) and 54A of the SF(LCB)R require all LFMCs and RFMCs, respectively, to put in place a risk management framework to identify, address and monitor the risks associated with customers' assets that they manage, which is appropriate to the nature, scale and complexity of the assets. Regulation 13 of the SF(LCB)R also requires REIT managers to identify, address and monitor the risks associated with its business activities in a manner that is commensurate with their nature, scale and complexity. Such risks include environmental risk, to the extent that it is material to the assets managed.

The Guidelines set out MAS' expectations on the Board and senior management to oversee the integration of environmental considerations into the asset manager's strategies, business plans and products. The proposed responsibilities of the Board include approving an environmental risk management framework and policies, and setting clear roles and responsibilities of the Board and senior management. The proposed responsibilities of senior management include developing an environmental risk management framework and policies, regularly reviewing their effectiveness, and allocating adequate resources to manage environmental risk of the assets managed.

MAS propose that where environmental risk is deemed material to the funds/mandates managed, asset managers should designate a senior management member or a committee to oversee environmental risk. This would promote clarity in individual accountability over environmental risk management, to ensure such issues are reviewed at a sufficiently senior level.

Research and Portfolio Construction

Asset managers in Singapore are currently at different stages in their implementation of environmental risk management practices. While a number of asset managers have made good progress in integrating environmental risk considerations into their investment approach, there are others that are only starting to assess the merits of doing so. It is important for asset managers to develop a risk management framework, and put in place robust policies and processes to manage environmental risk. In this regard, asset managers should identify, assess, monitor and mitigate material environmental risk at both an individual investment and/or portfolio level.

MAS expect asset managers to evaluate the potential impact of material environmental risk on an investment's return potential when carrying out research and portfolio construction. To inform the asset manager's assessment, the asset manager should apply appropriate tools and metrics to identify sectors with higher environmental risk. For such sectors, asset managers should develop sector-specific guidance to aid its investment personnel in understanding their attendant environmental issues. For portfolio construction, MAS expects asset managers to measure and manage environmental risk factors that are present in a portfolio on an aggregate basis, where material.

To assist asset managers in incorporating environmental risk considerations in their investment approach, examples of how asset managers can consider environment risk for different asset classes and investment strategies are included in the Guidelines.

Portfolio Risk Management

Developments, such as the occurrence of natural disasters and changes in regulations, could materially affect the operations and financials of an investee company. As such, MAS proposes that asset managers put in place 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. This would allow the asset manager to make an informed decision on whether to continue with the investment, make adjustments to the composition of the portfolio, or put in place other mitigating measures to better manage the environmental risk in the investment or portfolio.

MAS also propose that asset managers develop capabilities in scenario analysis to evaluate portfolio resilience and valuation under different environmental risk scenarios. These scenarios should incorporate forward-looking information to complement historical data, as the latter might systemically underestimate potential risks, in view of the uncertainties and long-term horizon associated with changes in the environment.

To assist asset managers in conducting scenario analysis, the Guidelines contain examples of possible metrics that asset managers could use to assess the potential impact of physical risk and transition risk on the assets in the portfolios.

Stewardship

Asset managers, acting as agents on behalf of their customers, are well-positioned to influence the actions of investee companies. MAS expects asset managers to exercise sound stewardship to help shape positive corporate behaviour and manage environmental risk associated with investee companies through engagement, proxy voting and sector collaboration. This includes supporting investee companies' efforts in the transition towards more sustainable business practices over time.

MAS propose that asset managers maintain proper documentation to support their engagement efforts and report on their stewardship initiatives.

Disclosure

Meaningful disclosure of an asset manager's environmental risk information improves the ability of stakeholders to evaluate the potential impact of environmental risk on the asset manager's strategies, business plans and product offerings. This facilitates market discipline and contributes to a more efficient allocation of capital over time.

MAS propose that asset managers disclose their approach to managing environmental risk and the potential impact of material environmental risk on the assets it manages. The latter includes quantitative metrics such as exposures to sectors with higher environmental risk. An asset manager's disclosure may be consolidated at the group or head office level.

MAS also propose that asset managers 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. The TCFD recommendations provide a useful framework for the disclosure of climate-related risks.

Implementation Approach

MAS have included examples of sound practices in relation to asset managers' governance, risk management and disclosure of environmental risk in the Guidelines, to facilitate implementation. The examples are meant to be illustrative and are not exhaustive. MAS also welcome suggestions of other examples of environmental risk management practices currently implemented by asset managers which would meet the expectations in the Guidelines.

Next Steps

MAS have invited interested parties to submit their comments on the proposed Guidelines by **7 August 2020**.

MAS appreciate that the maturity of environmental risk management practices varies among asset managers. Some asset managers may face initial challenges in implementing the Guidelines, including in relation to the availability of data and expertise for environmental risk management.

Hence, MAS proposes to provide a transition period of 12 months after the Guidelines are issued, for asset managers to assess and implement the Guidelines as appropriate.

Links to proposed guidelines on environmental risk management for asset managers, insurers, and banks and finance companies can be located on the MAS website.

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[i] Hereinafter collectively referred to as "asset managers."

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