ALLEN & OVERY

Singapore: Banks, Asset Managers and Insurers to Implement MAS's ESG Guidelines

Speedread

Banks, asset managers and insurers have 18 months to introduce and implement environmental risk management practices in accordance with new Guidelines on Environmental Risk Management. The Guidelines were issued by the Monetary Authority of Singapore on 8 December 2020. This note looks at the requirements in the Guidelines and suggests some preliminary steps that these financial institutions should start to take in order to ready themselves for compliance.

The Monetary Authority of Singapore (**MAS**) issued three new Guidelines on Environmental Risk Management (collectively, the **Guidelines**) on 8 December 2020. There was one each for banks, asset managers and insurers (**Relevant FIs**). The Relevant FIs have a transition period of 18 months to implement their respective Guidelines. They are to make their first disclosures in the next annual report / sustainability report following the end of the 18-month transition period and on their websites immediately after the 18-month transition period (ie, by 9 June 2022). Notwithstanding the transition period, the MAS expects the Relevant FIs to start the implementation process as soon as possible and will start engaging key Relevant FIs on their progress from Q2 2021.

In issuing these Guidelines, the MAS is following worldwide trends among financial regulators. The Prudential Regulation Authority in the UK, for example, in 2019 indicated that it expected regulated firms in the UK to consider disclosing how they have integrated climate-related financial risk into their governance and risk processes. In Europe, the European Commission has issued regulations on sustainability-related disclosure in the financial services sector which will apply from March 2021. The 18-month transition period adopted by the MAS will therefore allow the Relevant FIs adopt and adapt lessons learnt from the UK and Europe in their implementation of the Guidelines in the Singapore context.

Guidelines to be applied flexibly

Relevant FIs will find it useful to note that, the MAS recognizes that the field is still a nascent one where standards and protocols are still developing, both locally and internationally. It has indicated that it therefore expects the development of standards on disclosure and risk analysis to be an iterative process as all stakeholders ramp up their knowledge and experience over time.

In addition, and similar to the approach that has been taken with various initiatives introduced recently, the MAS has also indicated that the Guidelines may be applied in a manner that is commensurate with the size and nature of a Relevant FI's activities, as well as its risk profile. Therefore, Relevant FIs with limited resources and capacity may take measured steps to raise their environmental risk management capabilities.

General principles of risk management applied to environmental risks

Each of the Guidelines set out well established principles of risk management that the Relevant FIs will already have experience implementing with respect to other areas of risk. The Guidelines therefore generally require that the Relevant FIs take the following steps in implementing a system of environmental risk management:

– Having the Board and senior management take ownership of environmental risk management by ensuring effective oversight of environmental risk management and disclosure. The Board should ensure that there is a risk management framework in place, that they understand what environmental risk entails, and that there are persons at senior management and Board level who are responsible for oversight of the environmental risk.

– With a framework in place for environmental risk management and disclosure, the framework must be translated into effective policies and processes for identifying and assessing risk, putting in place practices and internal controls for risk management, and monitoring the risk so that there are timely updates to the Board and senior management. As with risk management in other areas, environmental risk management will include stress testing to determine the impact of various scenarios on the Relevant FI.

– A Relevant FI should also disclose to its stakeholders its approach to managing environmental risk. This may include disclosure of the potential impact of material environmental risk in quantitative terms on the Relevant FI.

While these broad principles of risk management will be familiar to the Relevant FIs, their application to environmental risk management pursuant to the Guidelines will require them to engage with customers and investments in a way that is novel.

In particular, in order for Relevant FIs to even start building a profile of their own exposure to environmental risks will require them to obtain details about the customer's or the investee's operating practices in a way that may not normally form a part of the interaction with the customer or investee. To the extent that some of this might be publicly available where the customer/investee has made its own environmental, sustainability or green disclosures as a listed company, the work will be simplified. The reality is, however, that not all customers/investee companies will have this information ready to hand, and the Relevant FIs will need to approach the customer/investee delicately. In addition, the Relevant FIs would also need to be able to understand and apply metrics of environmental risk assessment that would be outside the scope of their traditional expertise, and it may be necessary therefore to bring in third parties with the necessary environmental risk experience to work with them in carrying out this evaluation - which again - is not part of a Relevant FI's usual practices when dealing with their customers/investees.

In this regard, it bears repeating that the MAS has emphasized that it is cognizant that the practice of environmental risk management is very much in flux and development, and that it will continue to work with the Relevant FIs to finetune the implementation of the Guidelines and what it expects from them.

Who and what the Guidelines apply to

A high level overview of who each Guideline applies to and what the applicable Guidelines require of them is set out below.

Banks

The Guidelines on Environmental Risk Management (Banks) (**Bank Guidelines**) apply to all banks, merchant banks and finance companies in Singapore. The Bank Guidelines will apply on a group basis to locally-incorporated banks. Where the banks are headquartered in Singapore, this will include the holding company in Singapore, as well as the bank's subsidiaries and branches in Singapore and overseas, where applicable. For a locally-incorporated subsidiary of a foreign bank, this refers to the subsidiary's operations in Singapore and its downstream subsidiaries and branches in Singapore and overseas, where applicable.

The Bank Guidelines apply with respect to their provision of credit to corporate customers, underwriting of capital market transactions, and other activities that expose banks to material environment risk. This would include the bank's discretionary investment activities, both for itself and its clients.

In general, the Bank Guidelines require banks to assess each customer's environmental risk as part of their assessment process for the grant of credit facilities or for the bank's capital market transactions. This reflects the bank's exposure as a customer's environmental risk will have an impact on the bank's business. Customers with a high risk profile should be encouraged to lower their risk profile, and measures taken to reduce the risk profile will need to be assessed and monitored insofar as the bank is able. Where customers are not able to reduce their risk profile, the bank may wish to take this into account, for example, in determining how much exposure it should be taking to the customer.

Insurers

The Guidelines on Environmental Risk Management (Insurers) (**Insurer Guidelines**) apply to all insurers, including insurers carrying on business in Singapore under a foreign insurer scheme. As is the case for banks, the Insurer Guidelines will apply on a group basis for locally-incorporated insurers, and in the same manner.

The Insurer Guidelines require insurers to consider environmental risk in respect of their underwriting and investment activities, and other activities that expose insurers to material environmental risk. In general, with respect to underwriting, insurers should assess each customer's environmental risk as part of its underwriting assessment, particularly for sectors with higher environmental risk. Customers that pose a higher risk may require the imposition of underwriting conditions to lower risk or higher premiums to reflect the higher risk.

With respect to investments, insurers should consider the impact of environmental risk on the returns of the individual investments and portfolios on an ongoing basis. Developments that could materially affect the operations and financials of an investee company might require an insurer to re-assess the risk and return profile of the investee company or the investment portfolio. This would allow the insurer 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.

Asset managers

The Guidelines on Environmental Risk Management (Asset Managers) (**Asset Manager Guidelines**) apply to all holders of a capital markets services licence for fund management and real estate investment trust management, and to registered fund management companies in respect of investments of the funds/mandates that they are managing where they have discretionary authority. They do not apply where the asset managers do not have discretionary authority.

The Asset Manager Guidelines require asset managers to, among other things, embed relevant environmental risk considerations in their research and portfolio construction processes if they have assessed them to be material. Accordingly, asset managers should include an evaluation of the potential impact of relevant environmental risk on an investment's return potential. They should put in place appropriate processes and systems to monitor, assess and manage the potential and actual impact of environmental risk on individual investments and portfolios on an ongoing basis, where material.

Initial steps for consideration

The above is only a high level overview of the scope and key measures required by each of the Guidelines. Relevant FIs will need to review the applicable Guidelines to determine the steps they need to take in order to comply. We would, however, suggest a couple of useful first steps:

- In addition to the obvious steps such as setting up a team to look into the implementation of the Guidelines, one useful first step is to start a review of the existing customer or portfolio base to determine which of these operate in environmental high risk areas, and what those risks are. This would start to give Relevant FIs a sense of what their existing environment risk exposure is. The Association of Banks of Singapore's Guidelines on Responsible Financing set out a list of industries that would be considered environmental high risk industries and would be a good place to start the review.
- In addition to this, there are a variety of international risk assessment frameworks and guidelines that are now available, and part of the challenge for the team will be determining which of these are the right fit for the Relevant FI bearing in mind its environmental risk exposure, as well as the size and complexity of its operations. In this regard, the MAS has suggested in its Responses to Feedback that Relevant FIs consider sending staff to attend environmental risk management training courses, such as those provided by the Singapore Green Finance Centre.

As the Chinese saying goes, a journey of a thousand miles begins with a single step. Given the timelines for implementation that the MAS has set, it will not be too soon for Relevant FIs to make the first one.

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