CA | ESG
ComplianceAsia ESG Consulting

Singapore Regulatory Update – Environmental Risk Management Guidelines for Asset Managers in Singapore (October 2021)

The MAS published the Environmental Risk Management Guidelines for Asset Managers in Singapore (the "ERM Guidelines") in December 2020. A number of asset managers with offices in Asia had been waiting for Hong Kong's position on climate risk for fund managers to be finalised before implementing new or amended policies and procedures, in the hope of achieving a degree of consistency across their various Asian offices. Following the SFC's release of a set of amendments to the Fund Manager Code of Conduct ("FMCC") on 20th August 2021, many of you have approached us with questions about the ERM Guidelines and we have attached our detailed analysis of the new rules. At the end of this update, we have included some suggestions on the way forward and how to integrate the approach between Hong Kong and Singapore, if necessary.

Key Concept

The MAS defines environmental risk as the potential adverse effects of environmental change on economic activities and human well-being.

In summary, the MAS highlights three key risks which may financially impact funds / mandates:

- Physical risk arising from the impact of weather events and long-term or widespread environmental changes and this may impair the value of assets held by companies in the FMC's investment universe;
- Transition risk arising 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. Actions taken against polluting companies may also impair the value of those companies and portfolios may be exposed to downside risk and volatility where business models are disrupted due to environmental impact; and
- Reputational risk that may arise for FMCs that invest in businesses which have a negative impact on the environment and this in turn may impact on their ability to grow AUM.

Are you in Scope?

There are several thresholds that determine whether a fund management company ("FMC") falls within the scope of the ERM Guidelines.

The ERM Guidelines apply to all holders of a capital markets services licence for fund management ("LFMC") and real estate investment trust ("REIT") management, and to fund management companies registered ("RFMC") under paragraph 5(a)(i) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations ("SF(LCB)R").

The ERM Guidelines apply to funds (including REITs) and segregated mandates that are managed by FMCs where the FMC has discretionary authority over the investments of the funds / mandates.

Where the FMC does not have discretionary authority over the investments of the funds / mandates the ERM Guidelines do not apply.

FMCs that are part of global groups may follow or use their group governance structure, framework and policies for environmental risk management. Such FMCs that already have a group-wide environmental risk governance structure, policies, or frameworks may follow those group policies if they meet the requirements of the ERM Guidelines.

Hong Kong: +852 2868 9070 Singapore: +65 6533 8834 Mainland China: +86 147 1431 1859
Japan: +81 3 6837 5483 United Kingdom: +44 (0) 20 7213 0300 www.complianceasia.com

FMCs that delegate the investment management function to a sub-manager retain overall responsibility for environmental risk management. They are responsible for communicating the requirements of the ERM Guidelines to delegates and are responsible for monitoring the delegates' compliance on an ongoing basis.

The MAS notes that FMCs should implement the ERM Guidelines in a way that is commensurate with the size and nature of their activities, including the investment focus and strategies of their funds / mandates. This means that some FMCs may assess climate-related risks as irrelevant to their investment and risk management processes due to the nature of the investment or strategy (e.g. a quantitative fund, a macro strategy fund, an index tracking fund, a forex fund, a managed futures fund or a fund that trades on a high frequency basis).

As passive managers have limited leeway in their research and portfolio construction processes beyond benchmark selection and engagement of index providers on universe of sustainable indexes, stewardship is a key lever to manage environmental risk.

Active managers which have constraints on how much they can deviate from a reference benchmark or index but can still mitigate environmental risk in their portfolios by influencing their investee companies to have sound environmental risk mitigation measures.

The MAS also notes that it is not its intention to prohibit or restrict an asset manager from complying with applicable laws and discharging fiduciary duties and other legal obligations to its customers. This is of particular relevance to FMCs managing US ERISA funds, which have specific US Department of Labor rules governing their permitted ESG investment scope.

Timeline

The MAS recognizes that environmental risk management practices and methodologies for climate risks are better established at this stage. FMCs may therefore take a progressive approach towards environmental risk management by starting with better established areas and then moving on to other types of environmental risks as generally accepted methods and practices emerge.

Baseline Requirements

The MAS has set out several base line requirements for FMCs to meet:

1. Governance and strategy requirements;
2. Research and portfolio construction requirements;
3. Portfolio risk management requirements;
4. Stewardship requirements; and
5. Disclosure requirements.

Governance and Strategy

The obligations imposed on an FMC arise from regulation 13(B)(1)(a) and Regulation 54A of the SF(LCB)R which require all LFMCs and RFMCs 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 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.

The Board of Directors must approve an environmental risk management framework, setting responsibilities for the Board and senior management for oversight of environmental risk of the assets managed and ensuring directors have adequate understanding of environmental risk.

Senior Management is responsible for ensuring the development and implementation of an environmental risk management framework, monitoring exposures to environmental risk, reviewing regularly the effectiveness of the framework, establishing an internal escalation process for managing environmental risk and allocating adequate resources with appropriate expertise, including through managing the environmental risk of the portfolios. Senior management should also update the Board on material environmental risk issues in a timely manner.

Three Lines of Defence

FMCs must clearly allocate responsibilities for the management of environmental risk in accordance with the three lines of defence model:

- Business line staff must take into consideration environmental risk when establishing and managing funds/mandates, particularly sectors with higher environmental risk.
- Risk management must monitor the business line's implementation of the FMC's risk management policies, including challenging practices and decisions and compliance should ensure adherence to applicable rules and regulations.
- The internal audit function must review the robustness of the FMC's risk management framework in managing environmental risks.

Research and Portfolio Construction

If an FMC has assessed environmental risk considerations as material, it must embed those considerations in the research and portfolio construction process, risk management and stewardship practices across different asset classes and investment strategies. FMCs must also evaluate the potential impact of relevant environmental risk on an investment's return potential.

Risks for FMCs to Consider

1. Transitional and physical risks on an individual asset and/or portfolio level.
2. References from international standards and frameworks including the Global Reporting Initiative, CDP, the Sustainable Accounting Standards Board, and the Task Force on Climate-related Financial Disclosure.
3. Risk criteria to identify sectors with higher environmental risk, which may include levels of greenhouse gas emissions, vulnerability to extreme weather events and links to unsustainable energy practices, deforestation and pollution.
4. For sectors with higher environmental risk, FMCs should develop sector-specific guidelines to promote understanding of environmental issues relevant to these sectors. This should take into account internationally recognised sustainability standards and, where appropriate, certification schemes, as well as the invested company's strategy for managing its environmental risks.
5. The materiality of environmental risks differs between asset classes.

For equity investments, FMCs should consider the primary environmental risk factors that would affect the long-term success of the issuer. Country, industry and/or location-specific risk factors can affect an issuer's ability to deliver sustainable growth if not managed appropriately. Broader issues and trends such as the potential impact of climate change and extreme weather events may also be relevant.

For fixed income investments, FMCs may consider environmental indicators from the issuers and external environmental data providers, to achieve an impartial and holistic view of the environmental risk associated with a specific credit investment. If the credit investment is used to finance a specific project, the environmental risk profile of the project should also be considered. In addition, the seniority and maturity of the credit investment must also be taken into account when assessing the relevance and materiality of the environmental risk as they will expose investors to varying degrees of financial impact from the issuer's exposure to environmental risk.

For direct real estate investments, asset managers could consider operational indicators (e.g greenhouse gas emissions, energy management, waste and water management), the potential impact of new regulations on properties that do not meet minimum environmental standards, and the potential impact of climate change and extreme weather events, as well as the extent of the impact on potential tenant demand.

As there is no direct control over the real estate investments when investing in REITs, FMCs must assess the governance and strategy of the REIT manager in monitoring and evaluating the environmental risks of the assets within REIT.

FMCs are encouraged to use internal and external research from third parties as well as internal aggregate limits set by their customers for specific sectors or types of activities, such as sectoral limits for fossil fuel companies or caps on carbon emissions in the portfolio.

Portfolio Risk Management

FMCs should put in place appropriate processes and systems to monitor, assess and manage the potential and actual impact of environmental risks on individual investments and portfolios on an ongoing basis. In this way, the FMC can make informed decisions about whether to continue with a particular investment, adjust the composition of the portfolio, or take other actions to mitigate the environmental risk of the investment or portfolio in order to better manage it.

Scenario Analysis and Stress Testing

Where environmental risk is material in investment portfolios, FMCs should develop scenario analysis capabilities to assess the impact on their portfolios, including the resilience of portfolios to financial loss under a range of outcomes incorporating both short- and long-term environmental scenarios.

The analysis may include an assessment of physical and transition risks under a range of climate-related scenarios, including increases in global temperature and whether the transition to a low-carbon economy occurs in an orderly or disorderly fashion.

Physical risks may include the impact on revenue and profitability of investee companies that are more exposed to sea level rise (e.g. companies owning seafront properties) or extreme weather events (e.g. agricultural companies).

Transition risks may impact an investee company's cost of doing business if carbon prices increase. The analysis should consider whether the higher costs can be partially offset by rising prices and their impact on consumer demand.

FMCs must incorporate forward-looking information, as analyses based solely on historical data could systemically underestimate potential risks. When data is limited, FMCs can apply qualitative assessments of investee companies.

Proper documentation of all stress testing and analysis is expected to be retained.

Stewardship

FMCs should exercise sound stewardship to help shape the corporate behaviour of investee companies positively through engagement, proxy voting and sector collaboration.

This includes supporting investee companies' efforts in the transition towards more sustainable business practices over time, while maintaining the FMC's risk management standards.

Engagement may include:

- raising of environmental issues with investee companies to increase their awareness of environmental risks and opportunities;
- influencing the behaviour of investee companies to better manage and mitigate environmental risk;
- gathering information to supplement existing environmental risk disclosures from investee companies;
- encouraging investee companies to provide relevant and timely environmental risk data and/or clearer disclosures to improve data availability and consistency; and
- when investing in direct real estate, asset enhancement initiatives (e.g measures to improve energy and water efficiency or waste management or attaining green building certification).

Capacity Building

Asset managers are expected by the MAS to properly equip their current staff with sufficient training and resources to ensure appropriate addressing of the risks that present themselves.

Disclosure

FMCs should disclose their approach to managing environmental risk in a clear and meaningful manner to current and potential customers. Disclosures may be consolidated at the group or head office level.

All disclosures should be in the form of well-regarded international reporting frameworks, such as the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures, whose elements of include governance, strategy, risk management, metrics and targets.

The disclosures must be reviewed regularly to ensure that they remain relevant, clear and comprehensive.

Initial Action

At this stage, our recommendation is that we undertake a review of the degree to which the ERM Guidelines apply to your operations in Singapore considering the threshold questions set out above. This is a complex piece of work that is likely to incur an additional fee from us for those in scope of the regulations.

If engaged, we will provide you with a detailed written record of our assessment and the reasons for reaching the conclusions as to the degree of applicability of the requirements.

Once we have determined the extent to which you fall within the scope of the regulations, the follow-up action required is likely to be a combination of the following:

Hong Kong: +852 2868 9070 Singapore: +65 6533 8834 Mainland China: +86 147 1431 1859
Japan: +81 3 6837 5483 United Kingdom: +44 (0) 20 7213 0300 www.complianceasia.com

Applicability	Work Product
Out of Scope Managers – at entity level	A written governance structure explaining the analysis undertaken of applicability, the rationale for reaching this conclusion, confirmation that the Board of Directors has considered and confirmed this conclusion and a plan for regular reviews of the analysis to ensure that the conclusion remains accurate.
Certain funds out of scope	• Identification of which funds are not in scope because of their nature or strategy. • A written report including the rationale for this conclusion. • A governance structure explaining the analysis undertaken of applicability, the rationale for reaching this conclusion, confirmation that the Board of Directors has considered and confirmed this conclusion and a plan for regular reviews of the analysis to ensure that the conclusion remains accurate. • A plan for monitoring the funds to ensure that there are no changes in strategy or structure that may bring the fund into scope. • A plan for other forms of engagement in relation to that strategy as may be relevant.
Managers with investment management discretion	Determination of current ESG positioning • We will review any current Singapore policies and practices in relation to ESG integration generally and climate related risk specifically and provide a gap analysis against these existing policies and procedures. • If you operate as part of a larger group, we will review current group policies and practices and determine if any enhancements are required to be compliant with the Singapore requirements. • Full written reports will be provided to detail the work undertaken and the results identified. Implementation Plan • For firms with existing processes, we will provide a plan to incorporate the enhanced requirements into the existing processes. • For firms without current ESG / climate risk policies or procedures we will provide a detailed implementation plan and timeline to ensure that the baseline requirements.
Managers in Singapore that sub-delegate	The above work programme will be adopted and added to with a plan for the communication of these standards to the delegate, the way in which the Manager will monitor the activities of the delegate and the method for regular reporting and confirmation from the delegate to the Manager.

Hong Kong

If you have operations in both Singapore and Hong Kong, there is certainly room to adopt a regional policy incorporating the requirements of both the MAS and the SFC.

Hong Kong: +852 2868 9070 Singapore: +65 6533 8834 Mainland China: +86 147 1431 1859
Japan: +81 3 6837 5483 United Kingdom: +44 (0) 20 7213 0300 www.complianceasia.com

CA | ESG
ComplianceAsia ESG Consulting

Next Steps

We would be happy to arrange a call or meeting with you to discuss in detail the current status of your ESG compliance. Following this, we can provide an initial scope analysis, followed by a proposal for any substantive work support that may be required.

Please let your case manager at ComplianceAsia know what times and dates suit you best.

About ComplianceAsia

ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with offices in Hong Kong, Shanghai, Singapore, Tokyo and London. We have an unmatched track record of completing complex compliance consulting projects for financial firms in the APAC region.

With over 70 staff, including compliance experts with experience in dealing with the SFC, HKMA, MAS, CSRC, JFSA and Asian exchanges, we provide independent, unbiased advice on Asian financial industry legislation and regulations. Our international client base consists of asset managers, hedge funds, private equity funds, family offices, broker-dealers, insurers, wealth managers and investment banks.

About ComplianceAsia ESG Consulting

ComplianceAsia ESG Consulting is a specialist service to help Asian based financial industry firms deal with the fast-changing regulatory landscape of ESG investing in our region.

ComplianceAsia ESG Consulting offers a broad range of ESG services designed for firms in Asia Pacific starting on their journey towards ESG compliance and investment all delivered in an accessible and cost-effective way.

Whether you are responding to regulatory requirements or investor or stakeholder demands, our team of experts can help you with understanding your ESG obligations now and over the medium to long term.

For more information, please visit www.complianceasiaesg.com.

Hong Kong: +852 2868 9070 Singapore: +65 6533 8834 Mainland China: +86 147 1431 1859
Japan: +81 3 6837 5483 United Kingdom: +44 (0) 20 7213 0300 www.complianceasia.com

CA | ESG

ComplianceAsia ESG Consulting

Contact Us Today

HONG KONG
Suite 1102
ChinaChem Tower
34 - 37 Connaught Road
Central

T: +852 2868 9070

SINGAPORE
137 Telok Ayer Street
#03-06
Singapore 068602

T: +65 6533 8834

MAINLAND CHINA
Room 132, Unit 1301 - 1308
13/F Shanghai Tower
No.479 Lujiazui Ring Road
Pudong New Area Shanghai

T: +86 147 1431 1859

JAPAN
Level 2
Marunouchi Nijubashi Building
3-2-2 Marunouchi Chiyoda-ku
Tokyo 100-0005

T: +81 3 6837 5483

UNITED KINGDOM
1 St. Andrew's Hill
London
EC4V 5BY

T: +44 (0) 20 7213 0300
M: +44 (0) 7310 972435

www.complianceasia.com

ComplianceAsia

Philippa Allen
CEO
E: philippa.allen@complianceasia.com

Alex Duperouzel
Managing Director
E: alex.duperouzel@complianceasia.com

Lachlan Chubb
Regional Head of Regulatory Advisory and Projects
E: lachlan.chubb@complianceasia.com

Cherry Chan
Regional Head of Ongoing Support and Client Services
E: cherry.chan@complianceasia.com

Rachel Wu
Regional Head of Business Development and Compliance Manager
E: rachel.wu@complianceasia.com

DISCLAIMER

About ComplianceAsia Consulting Limited
ComplianceAsia Consulting Limited ("ComplianceAsia") is the longest established compliance consulting firm in Asia Pacific, established in 2003 with office in Hong Kong, Singapore, Shanghai, Tokyo and London. We have an unmatched track record of completing complex compliance consulting projects for financial firms in the APAC region. With 80 multilingual staff, including compliance experts with experience in dealing with the SFC, HKMA, MAS, CSRC, AMAC, JFSA and Asian exchanges, we provide independent, unbiased advice on Asian financial industry legislation and regulations.

The ComplianceAsia Group also includes AML Services Limited, OnlineCompliance.Training, CA College, CPTnow, and ComplianceAsia ESG Consulting.

About this publication

This publication contains general information only, and none of ComplianceAsia, or their related entities is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser or consultant.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of ComplianceAsia, its related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication. ComplianceAsia and each of its related entities are legally separate and independent entities.

@2021 ComplianceAsia Consulting Limited