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.

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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.

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.

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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.

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