

# Monetary Authority of Singapore Issues Guidelines on Environmental Risk Management for Asset Managers

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*December 11, 2020*

## **Introduction**

On December 8, 2020, the Monetary Authority of Singapore (MAS) issued: (a) its response<sup>1</sup> to the feedback received on the Consultation Paper on Proposed Guidelines on Environmental Risk Management for Asset Managers (Response) that was issued on June 25, 2020<sup>2</sup> and (b) the Guidelines on Environmental Risk Management for Asset Managers (Guidelines).

This update is targeted at (a) holders of a capital markets services license for fund management and (b) registered fund management companies, (collectively, Asset Managers) and is not intended to be exhaustive.

The Guidelines aim to enhance the resilience of funds and segregated mandates (collectively, funds/mandates) that are managed by Asset Managers, by setting out sound environmental risk management practices that Asset Managers can adopt.

The Response clarifies that the Guidelines convey MAS' expectations of Asset Managers in the area of environmental risk management, are not issued on a "comply or explain" basis and that Asset Managers are expected to implement the Guidelines in a risk proportionate manner.

## **Scope of application**

The Guidelines would generally be applicable to all Asset Managers that have discretionary authority over the investments of the funds/mandates that they are managing (in other words, the Guidelines will not apply to Asset Managers that do not have discretionary authority over the investments of the funds/mandates).

The Guidelines clarify that Asset Managers that delegate the investment management to sub-managers or advisors will still retain overall responsibility for environmental risk management and accordingly, should convey their expectations on environmental risk management to the sub-managers or advisors, and put in place appropriate processes and procedures to assess and monitor compliance with such expectations.

The Response clarifies that the Guidelines are not limited to only funds/mandates that have an environmental focus and that the Guidelines are also applicable to funds/mandates with passive strategies

### **Proportionate application and supervisory approach**

Asset Managers should refer to the specific guidance set out in the Guidelines and should implement the Guidelines in a way that is commensurate with the size and nature of their activities, including the investment focus and strategy of their funds/mandates.

Asset Managers which are part of global groups may take guidance from or leverage their group's environmental risk management governance structure, framework and policies, if they have determined that the group's governance structure, framework and policies meet the principles set out in these Guidelines.

The Response clarifies that as part of MAS' supervisory approach, MAS will consider how Asset Managers have incorporated environmental risk in their investment activities and in assessing how well an Asset Manager has observed MAS' expectations on environmental risk management, MAS will take into consideration the size and nature of the Asset Manager's activities and the relevance of such expectations given the investment focus and strategy adopted by the Asset Manager for its' funds/mandates.

### **Summary of key points under the Guidelines**

We set out in the table below a summary of the key points under the Guidelines.

<b>Scope of Environmental Risk</b>	<p>Environmental risk arises from the potential adverse impact of changes in the environment on economic activities and human well-being.</p> <p>Environmental issues that are of concern include climate change, loss of biodiversity, pollution and changes in land use.</p> <p>Environmental risk can vary by sector, geography, time horizon and other factors and accordingly, the extent of its relevance and materiality will vary depending on the investment horizon, focus, and strategy of the funds/mandates.</p>
<b>Governance and Strategy</b>	<p>The board and senior management should:</p> <ul style="list-style-type: none"> <li>• identify environmental risks and opportunities over the short and long term and evaluate the actual and potential impact of these risks and opportunities on the Asset Manager's strategies, business plans and products, including taking into consideration responses to the objectives set out under international agreements and national policies;</li> <li>• set the tone and articulate the Asset Manager's</li> </ul>

	<p>approach on environmental risk management for the different asset classes it invests in and investment strategies that it employs;</p> <ul style="list-style-type: none"> <li>• maintain effective oversight of the Asset Manager's environmental risk management and disclosure and also oversee the integration of environment risk into the Asset Manager's investment risk management framework; and</li> <li>• designate a senior management member or a committee to oversee environmental risk, to ensure that such issues are reviewed at a sufficiently senior level, where environmental risk is deemed material to the assets managed.</li> </ul> <p>Asset Managers should have in place a clear allocation of responsibilities for management of environmental risk in accordance with the three lines of defence model, (i.e. business line staff as the first line of defence, risk management and compliance functions as the second line of defence and the internal audit function as the third line of defence). The Response clarifies that for smaller Asset Managers which do not have the relevant function(s) and where the three lines of defence are not practicable, MAS will hold the CEO and directors accountable.</p>
<b>Research and Portfolio Construction</b>	<p>Asset Managers should:</p> <ul style="list-style-type: none"> <li>• embed relevant environmental risk considerations in their research and portfolio construction processes if they have assessed them to be material;</li> <li>• consider both transition and physical risks on an individual asset and/or portfolio level and take reference from international standards and frameworks;</li> <li>• apply risk criteria to identify sectors with higher environmental risk and develop sector-specific guidance to aid their investment personnel in understanding the environmental issues pertinent to such sectors;</li> <li>• be mindful of internal aggregate limits that their customers have set for specific sectors or types of activities; and</li> <li>• for portfolio construction, include measurement and management of the various environmental risk factors</li> </ul>

	<p>that are present in a portfolio on an aggregate basis, where material.</p> <p>The Response clarifies that for smaller Asset Managers, to address the issue of cost, one possibility is for them to initially rely on publicly available instead of proprietary information or paid databases to conduct their research on investee companies and identify sectors which are more affected by environmental risk.</p>
<b>Portfolio Risk Management</b>	<p>Asset Managers should:</p> <p><u>Ongoing Monitoring</u></p> <ul style="list-style-type: none"> <li>• 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, and escalate material environmental risk exposures and exceptions to ensure appropriate and timely actions are taken to address the risk;</li> </ul> <p><u>Scenario Analysis</u></p> <ul style="list-style-type: none"> <li>• where environmental risk is material in the investment portfolios, develop capabilities in scenario analysis (including keeping abreast of good practices) to assess its impact on the portfolios, including the portfolios' resilience to financial losses under a range of outcomes;</li> <li>• include short and long-term environmental scenarios (using conservative and regularly reviewed assumptions) into its scenario analysis of portfolios for risk management purposes, where relevant, and incorporate forward-looking information in such scenarios;</li> <li>• where data may be limited, consider qualitative assessments and engage investee companies to adopt practices and framework of disclosure that best identify the risks and opportunities most relevant to their businesses;</li> <li>• use the results of their scenario analysis when reviewing the environmental risk profile of their managed portfolios, as well as their environmental risk management policies and practices;</li> <li>• maintain proper documentation of the key features of</li> </ul>

	<p>the scenario analysis, including the choice of scenarios, reasonableness of assumptions, assessment of results, considerations on the need to take actions, and actions taken to address the risk;</p> <p>The Response clarifies that smaller Asset Managers can consider performing scenario analysis at an individual investment level, focusing on sectors which are more affected by environmental risk, using a more qualitative approach before progressing to conducting scenario analysis at a portfolio level and adopting a more quantitative approach.</p> <p>The Response also clarifies that Asset Managers are not required to disclose results of their scenario analysis to investors.</p> <p><u>Capacity Building</u></p> <ul style="list-style-type: none"> <li>• equip their staff, including through capacity building and training, with adequate expertise to assess, manage and monitor environmental risk in a rigorous, timely and efficient manner; and</li> <li>• regularly review capacity building programs to incorporate emerging issues relating to environmental risk management.</li> </ul>
<b>Stewardship</b>	<p>Asset managers are expected to exercise sound stewardship to help shape the corporate behaviour of investee companies positively through engagement, proxy voting and sector collaboration.</p> <p>Asset Managers should:</p> <ul style="list-style-type: none"> <li>• establish a process to prioritize issues and companies for engagement that is consistent with the interests of their customers and aligned with the Asset Manager's investment objective and strategy;</li> <li>• maintain proper documentation to support their engagement efforts, and report on their stewardship initiatives; and</li> <li>• consider collaborative engagements with other Asset Managers/investors for efficiency, enhanced influence and legitimacy when engaging investee companies, and to build knowledge and skills.</li> </ul> <p>The Response clarifies that Asset Managers have the flexibility to adopt the most appropriate stewardship</p>

	<p>approach(es), taking into consideration the significance and nature of their relationship with the investee company.</p> <p>The Response also states that smaller Asset Managers can consider working with like-minded investors to engage investee companies to address common environmental risk concerns and work towards more sustainable business practices over time and/or exercise proxy voting for investee companies that the Asset Managers have substantial exposure to and where the environmental risk is material.</p>
<b>Disclosure</b>	<p>Asset Managers should:</p> <ul style="list-style-type: none"> <li>• disclose their approach to managing environmental risk in a manner that is clear and meaningful to their stakeholders, including existing and potential customers;</li> <li>• ensure that disclosure is in accordance with well-regarded international reporting frameworks, such as recommendations by the Financial Stability Board's Task-Force on Climate-related Financial Disclosures, to guide their environmental risk disclosure; and</li> <li>• review their disclosures regularly to improve their comprehensiveness, clarity and relevance, taking into account generally accepted measurement practices and methodologies.</li> </ul> <p>The Response clarifies that for smaller Asset Managers, disclosures can be more qualitative in nature as a start and more quantitative metrics and targets can be included, where relevant, over time.</p> <p>The Response also clarifies that MAS accepts disclosure via annual reports, sustainability reports, investor reports and/or websites and that Asset Managers should evaluate the various means of disclosure and adopt an approach, as well as the frequency, that best enables them to provide clear, meaningful and timely information to their investors, customers and other stakeholders.</p>

### **Transition period and implementation**

MAS has stated in the Response that there will be a transition period of 18 months for Asset Managers to assess and implement the Guidelines as appropriate, however notwithstanding the foregoing, Asset Managers should strive to implement the Guidelines as soon as possible, and in phases where practicable.

The Response clarifies that MAS does not expect Asset Managers with limited resources and capacity to ramp up their environmental risk management capabilities immediately and instead, such firms can take measured steps to uplift their environmental risk management capabilities, such as accessing available online resources and attending environmental risk management training courses to gain relevant environmental risk management knowledge and proficiency.

MAS will start engaging larger Asset Managers from Q2 2021 on their implementation progress.

MAS expects Asset Managers' approach to managing and disclosing environmental risk to mature as the methodologies for assessing, monitoring and reporting such risk evolve and MAS will update the Guidelines as appropriate to reflect the evolving nature and maturity of risk management practices.

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<sup>1</sup> <https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Consultation-Papers/Response-to-Feedback-Received-on-Guidelines-on-Environmental-Risk-Management-for-Asset-Managers.pdf>

<sup>2</sup> <https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Consultation-Papers/Consultation-Paper-ENRM-Guidelines-AM.pdf>

## CONTACTS

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