SINGAPORE ESG REGULATIONS FOR FUNDS

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I. Introduction

Environmental risk is increasingly recognised as a key global risk, with climate change at the forefront of these concerns. Environmental, social and governance factors' ("ESG") integration in a company's corporate strategy as well as sustainability risk remains an important aspect in investors decision-making, with an increasing number of investors desiring more information on such strategies. Accordingly, there is a need for ESG regulations and consistent, comparable and reliable data and disclosures to guide decision making by financial market participants.

II. ERM Guidelines

The Guidelines on Environmental Risk Management ("ERM Guidelines") issued by MAS became effective on 8 June 2022. The guidelines apply to all holders of a capital markets services licence for fund management and real estate investment trust management (collectively "FIs"). Environmental issues that are of concern include climate change, loss of biodiversity, pollution and changes in land use. FIs are expected to incorporate these guidelines into their risk management frameworks.

In developing the ERM Guidelines, MAS has considered international standards of global organisations and regulators, such as the Task Force on Climate-related Financial Disclosures ("TCFD") and the International Sustainability Standards Board ("ISSB"). The ISSB has proposed two sustainability standards: IFRS S1 - General Requirements for Disclosure of Sustainability-related Financial Information, and IFRS S2 - Climate-related Disclosures. While not mandatory, they seek to standardise ESG reporting globally.

The Board of International Organization of Securities Commissions released a report on the Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management. They identified that the MAS' guidelines set out principles or "best practice standards" that guide rather than govern the conduct of specified institutions or persons and hence constitute a voluntary regime. Other jurisdictions like EU and Hong Kong, however, adopt a mandatory reporting framework, with more detailed disclosures required for larger sized firms and/or funds. It is also worth noting that the MAS guidelines extend the scope of ESG reporting beyond climate to other environmental issues including biodiversity, pollution and land use.

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. Presently, the Guidelines apply to all discretionary licensed and registered fund management companies. Where investment management is delegated to sub-managers or advisors, managers nonetheless retain overall responsibility for ERM and are expected to assess and monitor their sub-managers' or advisors' compliance with the Guidelines. MAS has clarified in the Responses to Guidelines that the ERM Guidelines will also apply to asset managers who adopt a passive investment strategy. For now, the ERM Guidelines do not apply to non-discretionary managers.

The ERM Guidelines broadly cover (i) governance and strategy, (ii) research and portfolio construction, (iii) portfolio risk management, (iv) stewardship and (v) disclosure of environmental risk.

(i) Governance and strategy

FIs need to develop a risk management framework and put in place policies and processes to manage environmental risk. The Board of Directors (the "Board") and senior management should oversee the integration of ERM policies into the risk management framework. Regulations 13(B)(1)(a) of the Securities and Futures (Licensing and Conduct of Business) Regulations require all LFMCs to put in place a risk management framework to identify, address and monitor the risks, which include environmental risk, associated with customers' assets that they manage. In particular, where environmental risk is deemed material to the assets managed, asset managers should designate a senior management member or a committee to oversee environmental risk, to ensure that such issues are reviewed at a sufficiently senior level.

The guidelines also set out specific responsibilities for the Board and senior management respectively. At an operational level, there should be the following:

Business line staff to consider environmental risks when establishing and managing funds/mandates;
Risk management and compliance to monitor the implementation of ERM policies and ensure their adherence to applicable rules and regulations; and
Internal audit function to test the robustness of the ERM framework.

(ii) Research and portfolio construction

Asset managers should evaluate the potential impact of material environmental risk on an investment's return potential when carrying out research and portfolio construction. The risk criteria may include the level of greenhouse gas emissions, vulnerability to extreme weather events, and linkages to unsustainable energy practices, deforestation and pollution. The Guidelines also provide examples of factors relevant to the materiality of environmental risk of various asset classes, including public equities, fixed income, direct real estate, and REIT investments.

For portfolio construction, asset managers should include measurement and management of the various environmental risk factors that are present in a portfolio on an aggregate basis, where material.

(iii) Portfolio risk management

With regard to Portfolio Risk Management, asset managers should implement appropriate processes and systems to monitor, assess and manage the potential and actual impact of material environmental risk on the portfolio on an ongoing basis. Where environmental risk is material in the investment portfolios, asset managers should develop capabilities in scenario analysis to assess its impact on the portfolios, including the portfolios' resilience to financial losses under a range of outcomes. Where data may be limited, asset managers should 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.

Asset managers should also engage in capacity building by providing environmental risk management training to staff.

(iv) Stewardship

Asset managers are expected to shape corporate behaviour of their 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, while maintaining the asset managers' risk management standards.

(v) Disclosure of environmental risk

Asset managers should make regular and meaningful disclosures of salient environmental risks and should take reference from international reporting frameworks, including the Financial Stability Board's Task Force on Climate-related Financial Disclosures. At a company level, environmental risk disclosures can be published on the groups' website, annual report and/or issued as a standalone sustainability report. These disclosures should be updated at least annually. At a product-level, retail ESG funds have additional disclosure and reporting requirements as set out in Circular No. CFC 02/2022 by MAS on Disclosure and Reporting Guidelines for Retail ESG Funds.

III. Greenwashing

Greenwashing is the act of making false or misleading claims that products or investments are more environmentally sound, or green, than they actually are. A fund that is sold to retail investors in Singapore using ESG factors as a key investment focus and strategy, or that represents itself as an ESG-focused scheme, will thus need to justify its ESG labelling. Such funds have additional disclosure and reporting guidelines. This includes the required details on a scheme's ESG focus, investment strategy, reference benchmark and risks associated with such ESG focus. Further, MAS has specified that the name of the ESG fund should not be misleading, which means that if it uses a term like "sustainable", the fund should reflect this focus substantially in its investment portfolio or strategy.

IV. How environmental risks impact funds

MAS acknowledged that environmental risk gives rise to reputational concerns and bears a monetary impact on asset managers and the assets they manage on behalf of their customers. The Guidelines state that environmental risks can impact funds and mandates through three risk channels:

Physical risk: the impact of weather events and long-term or widespread environmental changes;
Transition risk: a process of adjustment to an environmentally sustainable economy, including changes in public policies, disruptive technological developments, and shifts in consumer and investor preferences; and
Reputational risk: arises when asset managers invest in companies that carry out business activities that have a negative impact on the environment.

Environmental risks are translated into risk factors that may result in financial instability.

Physical risks eg. natural disasters, storms, rising sea levels, turn into economic costs and financial losses when the increased frequency, severity or volatility of extreme weather events leads to physical damage. As the frequency and severity of natural catastrophes increases, this can lead to non-insured losses which, in turn, can threaten the solvency of households, businesses and governments, and therefore also financial institutes. The physical risks are more likely to materialise in the long term and the perceived future risks can be underestimated in the short term.

Transition risks are associated with economic dislocation (such as large-scale job losses) and the financial losses that could result from the process of adjustment towards a low-carbon economy. Further the shift in consumer preferences, driven by a desire for more ethical or sustainable supply chains or products, can also affect products that are not environmentally friendly.

Reputational risk can arise due to negative perceptions around transactions with negative environmental impacts or failures to address customer demands for greater transparency, such as producing climate-related disclosures as required/expected by the market. Engaging in green investment activities would likely mitigate reputational risk for asset managers.

Accordingly, asset managers need to ensure the resilience of their customers' assets against the impact of environmental risk. By implementing robust and sound environmental risk management policies and processes, asset managers can play a key role in the transition towards an environmentally sustainable economy by channelling capital through their green investment activities.

https://www.pwc.com/gx/en/issues/c-suite-insights/global-investor-survey.html; https://www.deutschewealth.com/content/dam/deutschewealth/cio-perspectives/cio-special-assets/esg-survey-2023/CIO%20Special%20-%20ESG%20Survey%202023%20-%20Sustainable%20transition%20and%20investment.pdf

https://www.mas.gov.sg/-/media/mas/regulations-and-financial-stability/regulations-guidance-and-licensing/securities-futures-and-fund-management/regulations-guidance-and-licensing/circulars/cfc-02-2022-disclosure-and-reporting-guidelines-for-retail-esg-funds.pdf

Paragraph 2.3 of the Consultation Paper on Proposed Guidelines on Environmental Risk Management for Asset Managers

https://abs.org.sg/docs/library/handbook-on-implementing-environmental-risk-management

MAS Guidelines on Environmental Risk Management (Asset Managers) December 2020 <https://www.mas.gov.sg/-/media/mas/regulations-and-financial-stability/regulations-guidance-and-licensing/securities-futures-and-fund-management/regulations-guidance-and-licensing/guidelines/guidelines-

on-environmental-risk-management-for-asset-managers.pdf>