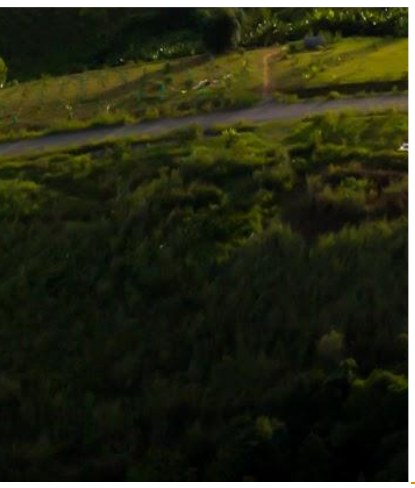


Risk and Regulatory Outlook 2021

Key developments in Southeast Asia: Environment, social and governance (ESG)

pwc

Environmental, social and governance (ESG)

Overview

The ESG concept refers to the three key factors - environmental, social and governance - used to identify the sustainability and social impact of a business. As in many other sectors, ESG has made its way on to the boardroom agenda of most players in the financial services industry.

Environmental and social risk management focuses on the risks caused by environmental change that can potentially impact banks' operational and financial viability. While insurance companies have been assessing and measuring physical environmental risk for decades, the concept of environmental and social risk management is comparatively new for banks.

Today, the banking industry and its regulators are increasingly aware of the ESG risks and their impact at an accelerated pace. Investors and businesses are increasingly committing to ESG goals and criteria. While asset managers often follow the full set of ESG aspects, banks currently tend to focus their adaptations in their corporate sustainability strategy and risk management on environmental and social aspects, based on the existing regulatory requirements. These include the KYC processes and credit assessment standards, that already cover many aspects of governance.

Why should banks care about ESG?

Customer acquisition

Attracting a new pool of customers (B2B and B2C) in sustainable industries and attract customers that like to transact with an organisation with purpose and sustainable products

New revenue generation

Understanding ESG implications and incorporating these into strategy and operations give banks the ability to offer more sustainable finance solutions to the market with more purpose, incentives and profitability

Physical / transition risk

Mitigating the direct impacts from environmental events on the existence of assets and the risks arising from the transition to more environmentally sustainable economies

Reputational risk

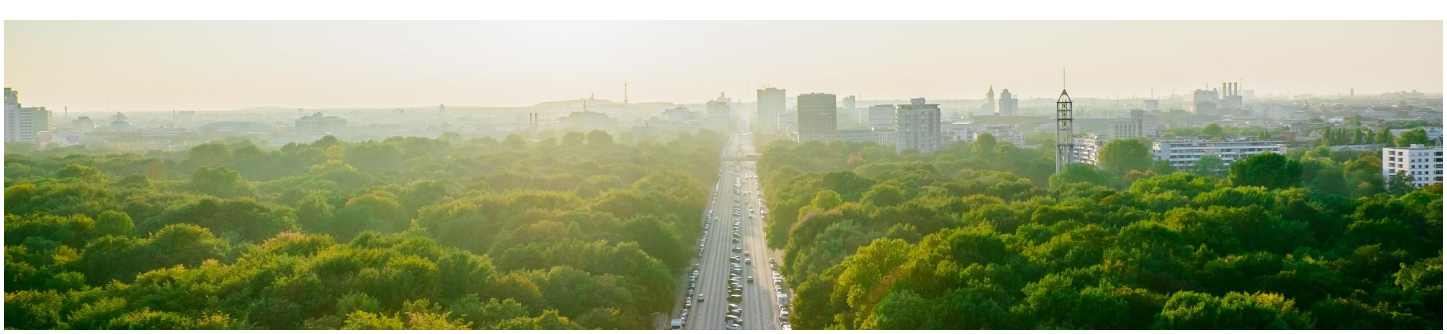
Integrating ESG practices into core business activities through sustainable developments, solutions, improving social injustices and policy changes can improve one's brand and positioning in the community

Reduced regulatory/legal interventions

Reducing companies' risk of regulatory non-compliance and adverse government/ legal actions amidst garnering potential government support and guidance by adopting ESG as part of an organisation's strategy, operations and governance

Productivity uplift

Boosting employee motivation and attracting talents by building stronger environmental and social credibility in its values and operations



Sources of ESG risks are commonly classified into two different categories:

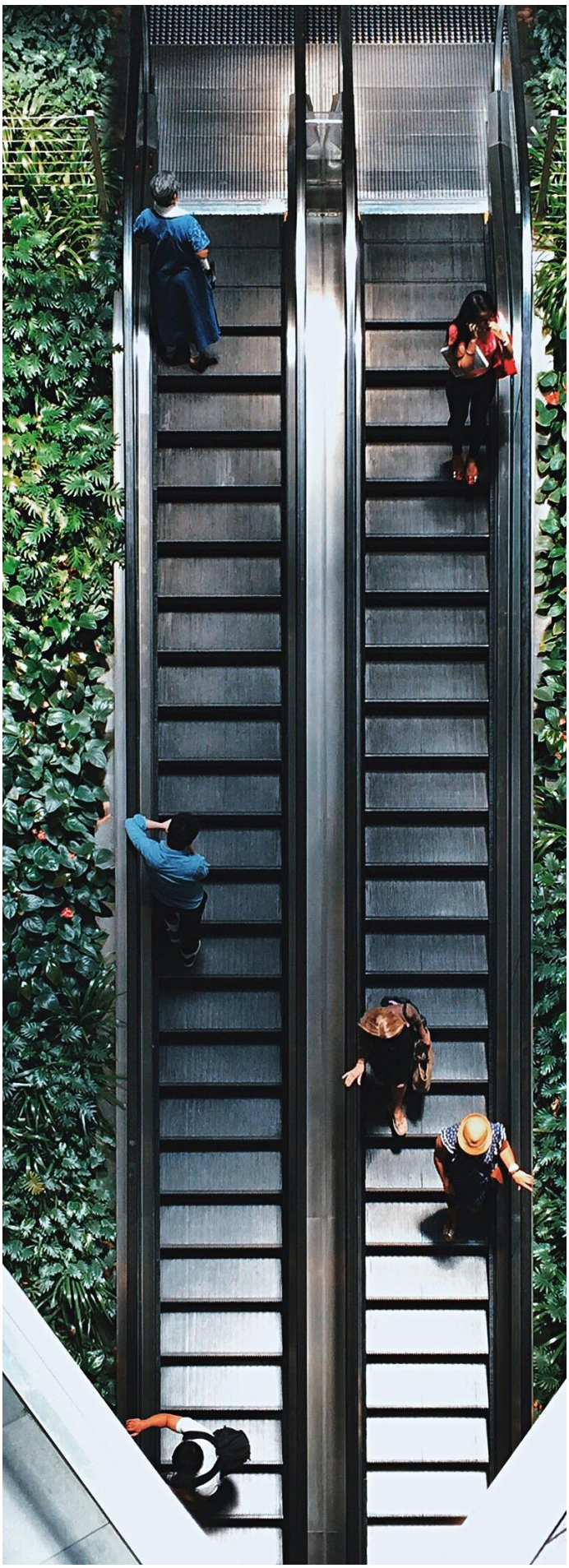
- **physical risks**: arising from the direct impact of environmental events on the existence of assets, e.g. floods, droughts or rising sea levels.
- **transition risks**: arising from the transition to more sustainable economies. Economic, social, political and legal changes can cause significant changes in asset values and feasibility, consumer and industry demand. These could also have subsequent impacts on the viability of a business or entire business models, e.g. shift to more renewable energy sources, electric vehicles or even a more vegetable-based diet.

These events and developments typically affect banks' financial risk areas, including:

- **credit risks** - inability of an obligor to fulfil its financial contractual obligations.
- **market risks** - declining asset values affect market prices of shares, bonds and other instruments.
- **liquidity risks** - unexpected drawdowns of commitments, withdrawal of deposits or depreciation of assets held by banks.

In addition, the non-financial risk areas are also significantly affected. These include:

- **operational risk** - from physical environmental events, as well as governance and social risk events, which may affect banks' properties and cause the failure of banks' internal processes and systems,
- **strategic risk** - arising from a lack of consideration for material environmental and social risk factors that can adversely impact the long-term viability of banks,
- **reputational risk** - arising from a negative perception of the bank by stakeholders due to poor management and disclosure of environmental and social risks,
- **legal risk** - caused by increased risk of legal obligations due to ignorance of environmental and social risk and related regulations
- **others** - such as conduct and fraud risks.



International initiatives and regulatory developments

Several international groups and initiatives have been working on the development of guidelines for ESG integration in the banks' strategies, risk management, disclosure and regulatory requirements with different scopes and goals.

Some initiatives focus only on climate risk-related implications, such as the Task Force on Climate-related Financial Disclosures (TCFD) under the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision's (BCBS) Task Force on Climate-related Financial Risks (TFCR).

In early 2020, the TCFR performed a stocktake and the results suggested that a majority of the members had already looked into approaches to measuring climate-related financial risks. However, most members had not yet incorporated climate-related risks into their prudential capital framework.[1]

Some initiatives aim to look at a broader sustainability scope. These include the United Nations Environment Programme Finance Initiative's (UNEPFI) Natural Capital Risk Assessment and Principles for Responsible Banking, the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI) and UN's Sustainable Development Goals (SDGs).

In September 2020, the Trustees of the IFRS Foundation published a Consultation Paper on Sustainability Reporting, which proposes the creation of a Sustainability Standards Board. It aims to leverage existing sustainability frameworks (e.g. from organisations such as the SASB, GRI, CDP, CDSB and IIRC) to develop and maintain a global set of sustainability-reporting standards initially focused on climate-related risk. The response had been supportive and the Trustees declared on 1 February 2021 that they will publish a final proposal by September 2021, targeting the announcement of the establishment of a Sustainability Standards Board at the meeting of the United Nations Climate Change Conference COP26 in November 2021.[2]

Most large banks have already been measuring and disclosing parts of their ESG impact in their annual or sustainability reports. However, they still face difficulties evaluating the environmental impact and the related risks in their conventional lending and investment portfolio. That's because banks have traditionally been creating sustainable or green banking products in addition to their conventional banking business. Regulators globally are increasingly encouraging banks to take action and develop proper risk management approaches to measure and manage the ESG risks of their entire business.

[1] BIS, "The Basel Committee's initiatives on climate-related financial risks", 2020.
[2] IFRS, "IFRS Foundation Trustees announce next steps in response to broad demand for global sustainability standards", 2021.

Regional regulatory developments and industry observations

While the need for sustainability disclosures seems to be addressed by most jurisdictions in Southeast Asia, Singapore and the Philippines are by far the only countries in the region that have moved ahead with incorporating environmental and social risk into their supervisory expectations for banks' risk management systems.

Singapore

(1) Consultation on the development of a taxonomy for Singapore and ASEAN

In January 2021, the Green Finance Industry Taskforce (GFIT), an industry-led initiative convened by the MAS, issued a consultation paper on a Taxonomy[3] that will ultimately provide a standardised set of criteria which will help classify economic activities as "green". The consultation is open until 11 March 2021.

Following similar initiatives by the European Union (EU), Malaysia and China, the taxonomy aims to set standards for the environmental assessment of economic activities. It is tailored to Singapore and ASEAN countries and will inform the steering of capital into sustainable and transitional activities. In addition, activities are subject to a "do not harm" clause which means that they are neither allowed to contravene any laws and regulations nor cause environmental or unjustifiable social or economic harm.

The taxonomy pursues four environmental objectives:

- climate change mitigation
- climate change adaptation
- protect biodiversity
- promote resource resilience

The development of the taxonomy will be based on an environmental and economic materiality assessment of industrial sectors, followed by the development of metrics and limits for common types of economic activities in those sectors. Activities would then be categorised with a traffic light system as a first step. Environmental-friendly activities would be classified as "green", transitional activities as "amber" and the remaining ones as "red". The taskforce suggests that later on, a more granular approach could be considered based on evolving practices and data availability.

[3] ABS, "Green Finance Industry Taskforce (GFIT) Taxonomy Public Consultation," 2020.

(2) Guidelines on environmental risk management

The MAS is one of the first regulators in this region that formally sets out comprehensive expectations for banks' environmental risk management and disclosures. It published the Guidelines on Environmental Risk Management for Banks on 8 Dec 2020. This document was developed with input from local industry associations, in line with the Green Finance Action Plan. The guidelines cover:

- governance and strategy
- risk management
- disclosure of environmental risk information

Banks are expected to implement the guideline during an 18-months transition period (starting from December 2020) and disclose its approach to managing sustainability risk in a manner that is clear and meaningful to its stakeholders, at least on an annual basis.

In comparison with similar regulatory initiatives around the world, MAS' approach is more principle-based than prescriptive. It focuses only on the more established type of ESG risk, i.e. environmental risk, whereas social and governance risks are excluded from the scope of the current guidelines. The MAS acknowledges the various international frameworks and recommendations such as SASB, CDP, TCFD among others and encourages the alignment of banks' implementation with international good practices on top of the issued Guidelines.

The MAS suggests an iterative implementation approach that aligns the development of risk measurement and management techniques with progress on the availability and quality of data. A further evolution of expectations, e.g. towards a full coverage of ESG risks, can be expected in the coming years.

Typical challenges banks are facing include but are not limited to:

- **Data availability and quality**
  Lack of relevant, comparable, reliable and user-friendly data. Even where data is available, it remains challenging to translate ESG risk factors into expectations for financial performance.

- **Uncertainty**
  Timing and impact of physical and transition risks are hard to predict. There's a broad range of possible scenarios with very different environmental and economic implications.

- **Methodological constraints**
  Not many methodologies have been established yet and historical data is not useful for analysis of future risks as e.g. climate change is not sufficiently reflected in historical data. Understanding and translating ESG risks into financial and non-financial risks remains difficult.

- **Multi-point impact**
  ESG risks will affect different prudential risk types, including credit risk, market risk, capital and liquidity adequacy, etc. It therefore requires broad mobilization and involvement of different divisions and departments of a bank.

- **Non-linear effects**
  When environmental events occur, their impact may be greater in relation to the instantaneous magnitude of the event itself. This can include the so-called "black swan events", e.g. extreme weather events and other hazardous physical risks, as well as the impact of policy changes on transition risk.

- **Time horizon mismatch**
  There may be a mismatch between "traditional" management tools and the time by which ESG risks materialise. Impacts of transition risk factors may develop over decades, while strategic planning horizons of risk management frameworks are typically shorter than e.g. climate pathways.

(3) Green finance action plan

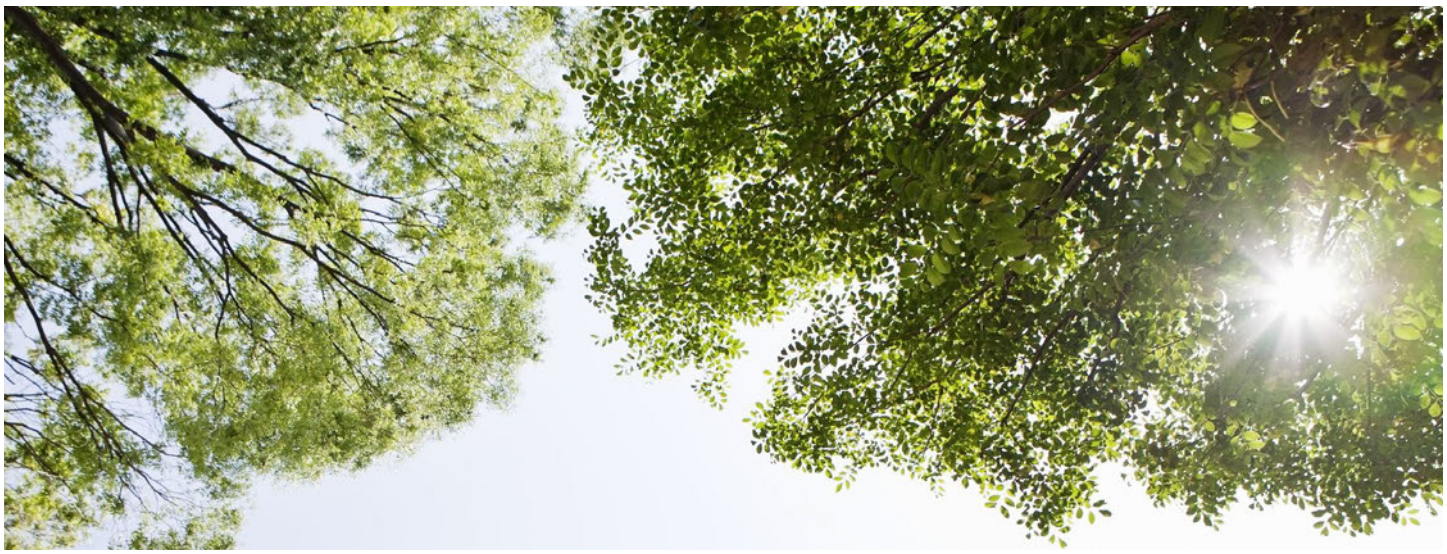
Apart from the management of ESG risks, the MAS has continued to develop other elements of Singapore's Green Finance Action Plan.[4]

This Green Finance Action Plan is a part of the broader Singapore's Green Plan 2030[5] that sets out the green finance-related target of positioning "Singapore as a leading centre for green finance and services to facilitate Asia's transition to a low-carbon and sustainable future".

The Singapore Green Finance Centre (SGFC)[6] was launched on 13 October 2020 by the Imperial College Business School and Lee Kong Chian School of Business at Singapore Management University (SMU). This is Singapore's first research institute dedicated to green finance research and talent development and is supported by the MAS and nine founding partners from the financial services industry.

The MAS also launched the Green and Sustainability-Linked Loan Grant Scheme (GSLS)[7] on 24 November 2020. The first of its kind globally, the GSLS seeks to support corporates of all sizes to obtain green and sustainable financing by defraying the expenses of engaging independent service providers to validate the green and sustainability credentials of the loan. The grant also encourages banks to develop green and sustainability-linked loan frameworks to make such financing more accessible to small and medium-sized enterprises (SMEs).

[4] MAS, "Sustainable Finance", 2020.
[6] MAS, "Singapore Green Plan - Green Economy", 2021
[6] MAS, "Singapore's First Centre of Excellence to Drive Asia-focused Green Finance Research and Talent Development", 2020.
[7] MAS, "MAS Launches World's First Grant Scheme to Support Green and Sustainability-Linked Loans", 2020.



Philippines

(1) Environmental and social risk management requirements

The Bangko Sentral ng Pilipinas (BSP) issued the Sustainable Finance Framework under Circular No. 1085[7] on 29 April 2020. While the full implementation of these requirements is required by May 2023, BSP expects banks to submit a board-approved transition plan upon request.

The framework defines key terminologies of the sustainable finance framework and defines supervisory expectations including:

- responsibilities of the board of directors and the senior management,
- implementation of an "Environmental and Social Risk Management System (ESRMS)", which requires an environment and social (E&S) risk appetite setting and the incorporation of E&S risks in the operational risk management as well as banks' stress testing practices,
- responsibilities, e.g. for units overseeing E&S management, internal audit and compliance functions and
- detailed sustainability disclosure requirements for banks.

Even before the Sustainable Finance Framework was issued, several banks had already taken steps towards integrating sustainability principles into their business operations. This circular introduces the need for an ESRMS as a new aspect of banks' risk management and its linkage to their sustainability strategies and goals.

As stipulated, banks have been developing their individual transition plans and roadmaps to the adoption of environmental and social risk management. These include both a strategic approach to environmental and social goals and risks as well as an operational implementation plan. Banks are also increasing the issuances of green, social and sustainability bonds. Their proceeds are used to fund and refinance renewable energy and energy-efficiency projects, among others.

(2) Disclosure requirements

For the annual reports for 2020, the new Sustainability Reporting Framework[8] comes into effect. It requires Philippine public companies to disclose details on their environmental and social impact. The SEC guideline makes reference to the Global Reporting Initiative's (GRI) Sustainability Reporting Standards, the International Integrated Reporting Council's (IIRC) Integrated Reporting (IR) Framework, the Sustainability Accounting Standards Board's (SASB) Sustainability Accounting Standards, as well as the Task Force on Climate-related Financial Disclosure (TCFD).

To adapt to evolving sustainability reporting standards, banks and other public companies are enhancing their sustainability disclosures in line with regulatory developments. In addition to the wide-spread adoption of the standards set by the Global Reporting Initiative (GRI) and the reporting against the Sustainable Development Goals (SDG), they are implementing supplemental elements from the abovementioned international standards and recommendations.

[7] BSP, "Circular No. 1085", 2020.
[8] SEC, "MC No. 04 s.2019 – Sustainability Reporting Guidelines for Publicly-Listed Companies", 2019.

Malaysia

In 2019, the Bank Negara Malaysia (BNM) set up the Joint Committee on Climate Change (JC3)[9]. This initiative is to encourage collaboration between financial regulators and FIs, to deepen their understanding on climate risks and develop tools to respond effectively . The main objective is to ensure that FIs have adequate measurement, mitigation and buffers against climate risk. Specifically, it aims for FIs to give greater consideration to climate risk in their risk management practices by 2022. In a recent development, the JC3 discussed the progress of its current initiatives and the focus of priorities for 2021, which include[10]

- adopting the TCFD disclosure recommendations,
- publishing a revised discussion paper on climate change and principles-based taxonomy in early 2021, following the comments and suggestions received from an earlier public consultation,
- pilot implementation of climate risk management and scenario analysis to further strengthen risk management practices in the financial sector and
- developing an application guide on climate-related disclosures to improve the quality of disclosures.

In addition, BNM has worked closely with the Ministry of Finance and the Ministry of Energy, Green Technology and Water to establish the Green Technology Financing Scheme (GTFS). While banks in Malaysia are not yet subject to regulatory requirements for their management of ESG risk (beyond disclosure), an increasing activity around the implementation of ESG aspects in banks' strategies can be observed. Banks are encouraged by initiatives such as the Malaysian Sustainable Finance Initiative (MSFI) whose members include The Association of Banks in Malaysia as well as the Association of Islamic Banking and Financial Institutions Malaysia.

More progressive banks have already started incorporating sustainability criteria into their risk management - in some cases limited to qualitative and sector-specific requirements while others explore more quantitative approaches. Incorporating E&S aspects in their business is not new to Malaysia-based banks, considering the Islamic banking and sharia-compliant financial services with the exclusion of undesired economic activities as well as the fact that e.g. CIMB was one of the founding members of the UNEPFI's Principles for Responsible Banking.

Indonesia

Among the first in SEA, Indonesia's Financial Services Authority (Otoritas Jasa Keuangan) issued its "Regulation on the Implementation of Sustainable Finance for Financial Services Companies, Issuers and Public Companies" as early as in 2017[11]. The implementation of this regulation in eight piloting banks as the first "prime movers" has been supported by the World Wildlife Fund (WWF) and the International Finance Corporation (part of the World Bank Group). The regulation promotes the consideration of sustainability criteria in banking products and banks' internal management and risk management systems, as well as the corresponding disclosure by listed banks in the form of sustainability reports. The requirements of this regulation will be rolled out to all banks until 2025.

The Indonesia Sustainable Finance Initiative (ISFI) is a market-led initiative by the financial services industry. It aspires to support the implementation of OJK's Regulation (POJK) Number 51 and Number 60 Year 2017 on Sustainable Finance Principles Implementation and Green Bond as the underlying regulation. It aims to promote and implement inclusive sustainable finance practices. The initiative serves as an open platform for banking and non-banking financial industry, corporate issuers and other relevant industry sectors. It aspires to support the implementation of Sustainable Financial Roadmap, which aims to enable the financial sector to contribute to the achievement of the National Long Term Development Plan (2005-2025) and the National Action Plan for the Reduction of Greenhouse Gas Emissions (2011), in order to achieve the country's Intended Nationally Determined Contributions (INDC).

[9] Malaysian Sustainable Finance Initiative, "Joint Committee on Climate Change", 2020.
[10] BNM, "Joint Statement by Bank Negara Malaysia and Securities Commission Malaysia - Accelerating climate action through the financial sector", 2020.
[11] OJK, "Regulation of Financial Services Authority No. 51/POJK.03/2017 on Application of Sustainable Finance to Financial Services Institution, Issuer and Publicly Listed Companies", 2017.

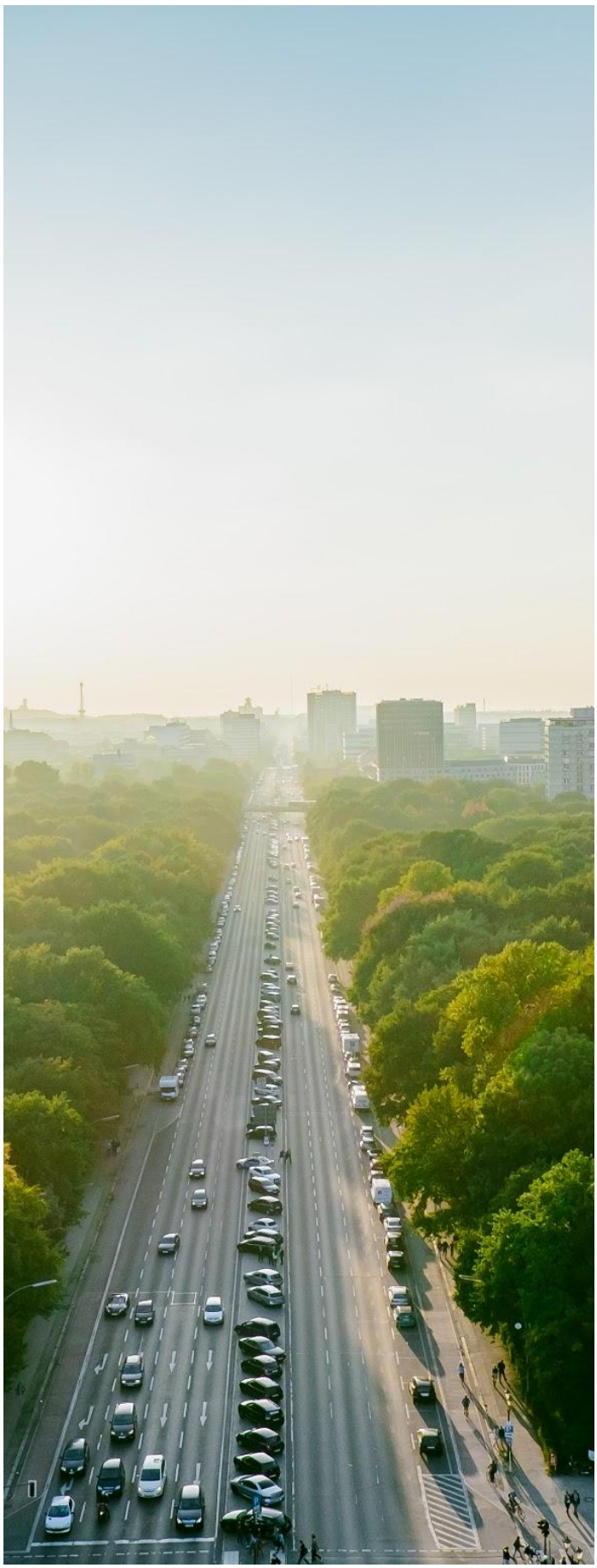
Outlook for 2021 and recommendations

Outlook #1: Alignment of environmental and social risk management with the broader enterprise sustainability strategy

Many banks in the region have already adopted sustainability aspects and goals in their vision, mission and strategy. With the introduction of ESG risk management requirements and increasing expectations for banks' disclosure, the need for coherence of banks' overall sustainability approach and environmental and social risk management becomes more urgent. A possible outcome of the implementation of ESG risk management can be a reshuffling of the sector allocation of their loan and investment portfolios. For instance, banks will be able to measure and quantify the exposure to ESG (in particular transition) risks stemming from their counterparties in so-called "high impact sectors" (which include old energy, inefficient transport, construction, chemicals, mining, plantations).

Recommendation: As banks are assessing their exposure to ESG risk, they will have to continue to define their broader roles in the transition of the economy. This may include increasing their business activities in new growth areas (e.g. green agriculture, social enterprises, aged care, affordable housing, renewables and energy solutions, new transport). Banks will need to align the scope and extent of these activities with their risk appetite and their overall enterprise sustainability strategy.

Exhibit 1: Addressing the needs of stakeholders, leveraging business opportunities and meeting regulatory requirements through coherent enterprise sustainability strategy and environmental & social risk management



Outlook #2: Strategic coherence and supervisory expectations will require holistic implementation of ESG risk management

Methodological and statistical approaches to measuring and managing ESG are still new and not yet well-established. It is expected that supervisors will assess the industry's implementation approaches and over time, turn the observed best practices into expected standards.

The uncertainty also lies in the environmental risk benchmarks that they will be measured against by supervisors, investors and the broader public if banks use different KPIs/KRIs and limits. In the long run, it is likely that supervisors extend existing environmental risk requirements further by including social and governance factors to align sustainable lending standards with asset management approaches, as is the case with the European Banking Authority[12].

On a global front, it is anticipated that more collaborations and recommendations from the existing groups and initiatives will arise and these might culminate into local regulatory requirements. In fact, we see an increasing speed of such developments ahead of the 26th UN Climate Change Conference in Glasgow in November 2021.

As such, a convergence of standards for approach, measurement, disclosure and reporting within the banking industry is expected. Most supervisors around the world seem to suggest an integration of ESG risk in existing risk types, rather than creating a dedicated sustainability risk area. This requires banks to integrate physical and transition risk into their existing risk management framework. Banks will have to adjust new processes, update their KPI/KRI measurement and management systems, adjust policies and processes across the entire organisation and incorporate new techniques and industry best practices as they evolve.

Recommendation: Banks should aim at a holistic initial implementation of ESG risk management across all impacted areas. They might look at the implementation of ESG risk management as an iterative process rather than a one-off project. The implementation may start with limited and possibly rough techniques in some areas that will be enhanced and supplemented (or replaced) in subsequent iterations when more accurate methods, measures and data are available.

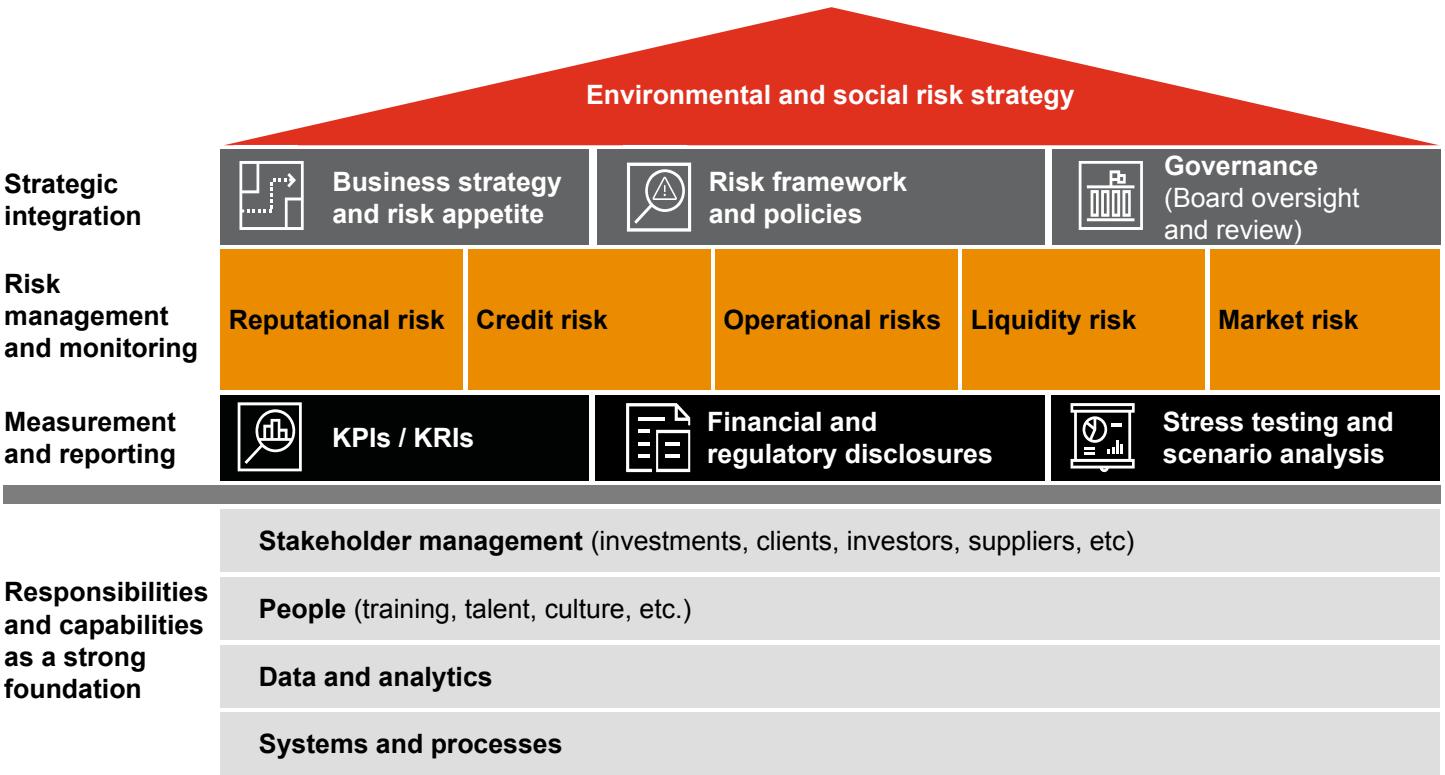
[12] EBA, "Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms (EBA/DP/2020/03)", 2020.

It is important to start off with a holistic approach that focuses on the right goals and defines the structures and techniques that will be enhanced over time. Summarised in the diagram below, key components of a holistic implementation include:

1. environmental and social risk strategy, aligned with the overall sustainability strategy
2. strategic integration, which consists of strategy adjustments and risk appetite statement, governance and risk frameworks and policies
3. risk management and monitoring
4. measurement and reporting
5. additional considerations include but are not limited to:
   - stakeholder management (in particular towards customers and investors),
   - bank's culture
   - Capturing and managing ESG data and using data analytics
   - robust ESG-related systems and processes

During the initial implementation, it will be critical to strike the right balance of invested efforts and expected insights into environmental and social risks. Banks can thereby rely on best practices adopted from other industries and follow an iterative implementation approach. They might start with scenario analysis and stress-testing as a first step and implement industry good practices as they are evolving. In the beginning, banks might also need to identify alternative data sources and proxies that address the data and methodological constraints currently faced in performing ESG risk assessments.

Exhibit 2: Elements of a holistic environmental & social risk management framework



Outlook #3: Sustainability considerations will be extended from "green" products to all products and services

Progressing from their earlier focus on their direct carbon footprints and dedicated "green" products and services, banks are increasingly expected to take a holistic view of the financial and non-financial risks from transition and physical risk. This means extending their focus to include carbon emissions from borrowers, as well as the determination, measurement and ongoing monitoring of banks' total exposure to ESG risk. The scope of environmental and social risk management for banks is no longer limited to green products and services, but should also include their entire lending and investment/trading portfolio with respect to its environmental impact as well as social criteria, such as increased focus towards forced labour standards and foreign worker living conditions in SEA companies in the past year.

Recommendation: Banks should take actions to enhance their risk strategy, risk appetite, risk management and disclosures to take into consideration sustainability risks from a holistic point of view. This may include the following initiatives:

- enhancing the bank's risk management framework to include environmental and social risk management, in line with the management of such risks defined in the risk appetite and business strategy,
- including ESG risk aspects in established risk types and areas within the bank (e.g. credit risk, liquidity risk, market risk, operational risk, reputation risk) and
- defining Key Risk Indicators (KRIs) to measure the bank's exposure to ESG risks,
- analysing the impact of ESG risks (both on-balance-sheet and off-balance-sheet) to existing material risk areas the bank is exposed to.

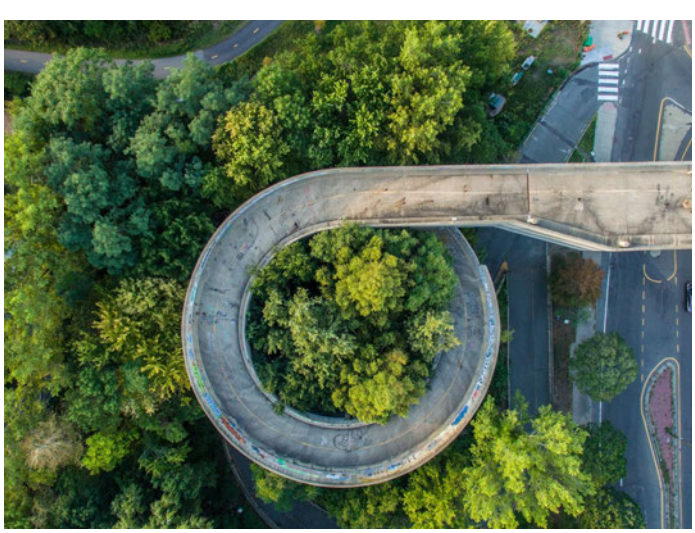
Outlook #4: There will be increased standardisation for sustainability definitions as taxonomies are being developed

With taxonomies already being developed in Singapore and Malaysia, consistent definitions and criteria for sustainable and non-sustainable activities will evolve over time. These taxonomies will provide a comparable yardstick for investors and banks that are looking to consider environmental aspects of their decisions, within a country and potentially in the whole ASEAN region.

The introduction of a green taxonomy can therefore be a gamechanger for national and regional economies given that capital will likely be steered away from harmful endeavors for the benefit of environmental-friendly and transitional activities. Investors will be able to use a common standard - the taxonomy - and combine it with their own criteria: their strategic position towards sustainability and their individual appetite for environmental risk exposure.

Recommendation: Banks might want to reduce their exposure to or involvement in potentially "red" activities which may accelerate a shift of capital and funding to greener parts of the economy. "Amber" activities will likely be subject to a deeper assessment and due diligence by banks and investors. Investment and banking products that are labelled as "sustainable" or "green" will likely be tailored to activities that are "green" by the criteria set out in the taxonomy.

Banks should also take these standards into account when assessing their lending and investing activities against their own sustainability strategy as well as their environmental risk limits. This will influence companies, particularly those in sectors identified as "material" in the taxonomy, to transition to a more sustainable business. Otherwise, companies could face higher cost of funding and an increasing unwillingness of investors or banks to provide funding.



Outlook #5: Increasing demand for consistent data and reporting standards across the industry

Most banks that are currently in early stages of environmental and social risk management implementation will likely face a lack of consistent industry-wide definition of KRIs and internal data availability and data quality constraints.

While large public companies typically disclose their sustainability impact and are subject to regular ESG ratings, banks may not necessarily be aligned in how these ESG ratings and standards are used and incorporated into their risk models. Additionally, there are discrepancies between the credit ratings themselves, as there is a large number of ratings providers using different approaches - the same company can be top-rated by one agency while another considers them at the bottom of the scale. A considerable challenge specific to banks is that retail customers and SMEs are not usually able to provide the same disclosures data, not to mention ESG ratings, that are typically available for large public entities. On the other hand, such customers may represent considerable portions of banks' financial exposure which, in the long run, cannot be ignored.

Recommendation: Banks will have to identify alternative data sources and proxies that allow for an assessment of this very material part of their portfolio. Potential data sources include:

- information from the sustainability-related disclosure of companies, where available (however, the lack of a single global standard and inconsistencies in the use and definition of KPIs affect the comparability of sustainability reports across different companies and puts limitations to the use in banks' environmental and social risk management),
- information available from NGOs and governments,
- aggregation of public sentiment from social media or other information from public domains and
- using geo-spatial sources to map assets to locations to identify their physical risk exposure when performing due diligence processes.

One example for capturing such data is the Science Based Targets Initiative (SBTI) that provides a methodology for measuring an organisation's greenhouse gas emissions.

Outlook #6: Increasing demand for ESG-trained resources across an organisation

Banks have traditionally been home to large pools of risk management talents in financial and non-financial risk areas relevant to banks. Instead of being merely a risk management project or a quick revision of the risk appetite, there is an increasing acknowledgement that environmental and social risk management requires a holistic implementation across a bank. This requires the involvement of almost all business units, divisions and functions across the bank.

With the emergence of environmental and social risk management as a requirement and discipline, new competencies and expertise will be required. This is true for banks' board members, senior management as well as existing operational working level staff. Job profiles will need to include necessary expertise in sustainability related issues. While banks may look to hire sustainability experts in environmental and social risk management from outside the banking industry, these experts might lack risk management and industry knowledge.

The undersupply of talent with true understanding of the impact of ESG issues on banks' risk and performance, may result in significant competition between banks on hiring ESG advisors (including Board advisors) with relevant banking and risk experience.

Recommendation: Apart from onboarding new talents, banks should adopt a comprehensive training program to upskill existing employees at all levels and functions of an organisation that are involved in environmental and social risk management processes.

However, upskilling alone may be insufficient. It is important to compliment the upskilling initiatives with a comprehensive change management program to ensure employees actively embrace change and that its impact is long lasting. For a start, banks may consider appointing 'knowledge champions' as an efficient way of raising competencies and awareness across the organisation.They will also need to factor in sustainability aspects into their specific areas of focus and responsibilities, so that various functions can work together and contribute to the development of a holistic environmental and social risk management.

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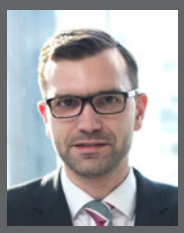

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