



HONG KONG MONETARY AUTHORITY
香港金融管理局

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The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Range of practices for management of climate risks

I am writing to share with Authorized Institutions (AIs) practices adopted by major banks to manage climate risks observed by the Hong Kong Monetary Authority (HKMA) in a recent study.

There is growing recognition that climate risks are a source of risk for the financial sector, and can affect the safety and soundness of AIs and the broader financial system if not properly managed. In view of this development, the HKMA published a White Paper¹ on 30 June to set out its initial thoughts on supervisory expectations on green and sustainable banking around four areas:

- *Governance* – AIs should develop a governance framework for climate resilience. The Board should oversee the development and implementation of the AI's climate strategy.
- *Strategy* – AIs should embed climate considerations throughout the strategy formulation process, while organisational structures, business policies, processes and resources availability should be reviewed and enhanced to ensure effective strategy implementation.
- *Risk management* – AIs are expected to incorporate climate risk considerations into their existing risk management framework. They should identify the transmission channels and assess the impacts of physical and transition risks arising from climate change on their business. To this end, AIs should build capability over time to measure climate risks using various methodologies and tools, particularly scenario analysis. They should also implement processes to monitor and report exposures to climate risks and carry out measures to control and mitigate the exposures.

¹ <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200630e1a1.pdf>

- *Disclosure* – AIs should develop an approach to disclosing climate-related information to enhance transparency. When considering the information to be disclosed, AIs should take the Task Force on Climate-related Financial Disclosures (TCFD) recommendations as the core reference.

In formulating these initial thoughts, the HKMA engaged selected major banks in a series of discussions to understand their approach to managing climate risks in the above four areas. During the discussions, the HKMA observed a range of practices that the more advanced AIs have adopted or plan to adopt in their management of climate risks, which may be of reference value to other institutions. These practices are discussed in detail in the **Annex**.

AIs are recommended to give consideration to these practices when developing their risk management framework. It should be noted that the intention of this circular is to inspire rather than prescribe how AIs should develop their approach to the management of climate risks. AIs should take into consideration the nature, scale and complexity of their businesses, and ensure that their risk management framework is proportionate and fit for purpose.

Furthermore, AIs should note the importance of being agile and responsive to changes when managing climate risks given their distinctive nature. Climate risks (which include physical and transition risks), are the products of multiple interacting forces (e.g. natural, technological and societal), and are thus inherently uncertain and prone to changes. Compared to the traditional risk types, climate risks are more susceptible to non-linearity and fat-tailed distributions, which means AIs will not be able to solely rely on historical data or established patterns when conducting modelling, nor could they rule out the possibility of more extreme events. Accordingly, AIs should keep abreast of latest standards on climate risk management and make adjustments to their approach based on actual developments.

Separately, the HKMA will invite interested AIs to participate in a pilot climate change stress testing exercise with a view to assessing the climate resilience of the sector as a whole. Noting that the use of stress testing to measure climate risks is a relatively new development, the HKMA will first collect feedback from the participating banks on the scope, scenario and outputs of the exercise before launching it next year. More details regarding the pilot exercise will be provided to the industry in due course.

Yours faithfully,

Raymond Chan
Executive Director (Banking Supervision)

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