HONG KONG MONETARY AUTHORITY
香港金融管理局

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30 June 2022

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Embedding climate risk in banking supervision

I am writing to share with the industry the Hong Kong Monetary Authority (HKMA)'s two-year plan to integrate climate risk into its banking supervisory processes.

Climate risk management has been a key supervisory focus of the HKMA since 2019. The HKMA has rolled out a series of measures to promote green and sustainable banking as a means to address climate risk. In December 2021, the HKMA set out its supervisory expectations for authorized institutions (AIs) to incorporate climate risk considerations into their strategies and frameworks in a new Supervisory Policy Manual (SPM) module GS-1 on "Climate Risk Management". In the same month, the HKMA also issued a circular to share with the industry some sound practices that support the transition to carbon neutrality, and completed a pilot climate risk stress test exercise to assess the climate resilience of the banking sector.

Building on the above work, the HKMA has recently completed a comprehensive review of its existing supervisory processes and has developed a two-year plan to weave climate risk considerations into these processes. We see merits in sharing our plan with the industry so that AIs can, where necessary, adjust their climate strategies correspondingly.

The HKMA's two-year plan comprises the following key initiatives:

1. **Including climate risk management as a standing item of prudential meetings** – The HKMA will make use of the annual prudential meetings with bank management for the next two years to check on the progress made by individual institutions in addressing climate risk, including their compliance with the new SPM module GS-1 on "Climate Risk Management" and adoption of the measures in the HKMA's circular on "Sound practices supporting the transition to carbon neutrality".

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2. **Updating the CAMEL rating framework and the SPM module SA-1 on "Risk-based Supervisory Approach"** – Enhancements to the CAMEL rating framework and the SPM module SA-1 on "Risk-based Supervisory Approach" will be worked out in the second half of this year to ensure that sufficient emphasis is accorded to climate risk management by HKMA supervisors.

3. **Conducting thematic examinations on selected areas of climate risk management** – Noting that many AIs have expanded their green and sustainable product offerings, the HKMA will undertake a round of thematic reviews in the second half of this year to assess the due diligence processes of AIs for these products, with a view to understanding how the industry is mitigating and managing the potential greenwashing risks. The HKMA also plans to commence another round of thematic reviews focused on climate-related risk governance in 2023, after the 12-month implementation period for achieving compliance with the new SPM module GS-1 on "Climate Risk Management" has lapsed.

4. **Integrating climate risk stress test into the supervisor-driven stress-testing framework** – Drawing on the lessons learnt from the pilot climate risk stress test exercise completed last year, the HKMA is refining its approach to evaluating the overall climate resilience of the banking sector. The current intention is to conduct another round of climate risk stress test between 2023 and 2024, as part of the regular supervisor-driven stress test exercise. AIs participating in the exercise will be asked to assess their resilience under multiple stress scenarios featuring extreme climate situations and adverse economic and financial environment.

5. **Enhancing the "greenness" assessment framework** – Following the completion of the first "greenness" assessment in 2020, the HKMA is reviewing the framework to better encompass measures taken by banks in managing climate risk, as well as to explore a wider scope, such as other environmental risks and transition considerations. The second "greenness" assessment is expected to commence in the second half of this year, based on the revised assessment framework.

6. **Keeping the regulatory framework under review** – The HKMA is considering whether and how to incorporate climate risk into its Supervisory Review Process (i.e. Pillar 2 of the Basel regulatory capital framework), with a view to incentivising AIs to enhance their risk management framework to address risks related to climate change and transition to carbon neutrality. At the same time, through directly participating in relevant international forums, the HKMA will also closely monitor international discussions on refining the minimum capital requirements under Pillar 1 and the disclosure requirements under Pillar 3 to address climate risks.

We appreciate that many AIs have devoted significant resources towards developing their climate strategies and building up their climate risk management framework. In developing the above plan, we have taken into consideration the incremental demand it would place on AIs' resources. To support the industry in dealing with the challenges arising from climate change, the HKMA will continue to support AIs in developing their climate risk management capabilities. The Alliance for Green Commercial Banks, established jointly by the HKMA and the International Finance Corporation organises capacity building events regularly to promote the understanding of green finance in Hong Kong as well as other emerging financial markets in the region. A green and sustainable finance module under the Enhanced Competency Framework for Banking Practitioners is also being developed.

Separately, we are exploring measures to improve the availability and usability of data and possible tools, as well as to strengthen the green ecosystem. In collaboration with other financial authorities under the Green and Sustainable Finance Cross-Agency Steering Group (CASG), we are also exploring the development of a local green classification framework. More details will be announced by the CASG in due course.

Should you have any comments about this circular, please feel free to approach your usual supervisory contact.

Yours faithfully,

Arthur Yuen
Deputy Chief Executive