

Building a Sustainable Financial System

Climate change presents an important source of risk to the financial system. The HKMA has been prioritising its efforts in strengthening Hong Kong's financial system to build a greener and more sustainable future, contributing to Hong Kong's climate goal and global agenda on sustainability.



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Banking supervisor

Banks, through their day-to-day activities, are exposed to the impact of different sustainability and climate-related issues. To continue to play their important role in the financial system and channel more capital to green and sustainable activities, it is crucial for banks to proactively manage climate risks. As a banking supervisor, the HKMA focuses on building banks' resilience against climate risks and climate risk management capabilities, and accelerating their efforts in supporting the transition to a low-carbon economy. The HKMA also supports the ability of banks to detect environmental crimes, and has supported the recent publication of Hong Kong's Money Laundering and Terrorist Financing Risk Assessment which includes, for example, environmental crimes and illegal wildlife trafficking.

Building climate resilience

Enhancing the supervisory framework

During 2022, the Basel Committee on Banking Supervision (Basel Committee)¹ published principles for the effective management and supervision of climate-related financial risks. It also issued responses to frequently asked questions to clarify how such risks may be captured in the existing Basel Framework. Taking into account these international developments, the HKMA has been working to incorporate climate-related considerations into the supervisory framework.

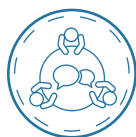
Following the issuance of the Supervisory Policy Manual (SPM) module GS-1 on "*Climate Risk Management*" in 2021, the HKMA has also been engaging with banks to exchange views about expectations, progress and challenges in implementing these supervisory requirements.

¹ The Basel Committee is the primary global standard setter for the prudential regulation of banks and provides a forum for co-operation on banking supervisory matters.

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Embedding climate risk considerations in the supervisory process

With a view to further stepping up its supervision of climate risk management of banks, the HKMA developed a two-year plan to embed climate risk considerations into its banking supervisory processes. The two-year plan, which was communicated to the industry in June, encompassed six key initiatives, namely:



Including climate risk management as a standing item of prudential meetings



Updating the HKMA's risk assessment framework for banks to incorporate climate risk considerations



Conducting thematic examinations on selected areas of climate risk management



Integrating climate risk stress test into supervisor-driven stress testing framework



Enhancing the HKMA's "greenness" assessment framework for banks



Keeping the capital framework under review

As part of the implementation of the two-year plan, the HKMA issued a revised SPM module SA-1 on "*Risk-based Supervisory Approach*" and enhanced the CAMEL² assessment framework by incorporating climate risk into its risk-based supervisory processes. In parallel, the HKMA took steps to enhance the scenarios and assessment framework for climate risk stress test (CRST) having regard to the experience gained from the pilot exercise conducted in 2021. The HKMA also developed a plan to integrate the next round of the CRST into its regular supervisor-driven stress test with the aim of conducting a more comprehensive assessment of the banking sector's resilience under extreme climate scenarios.

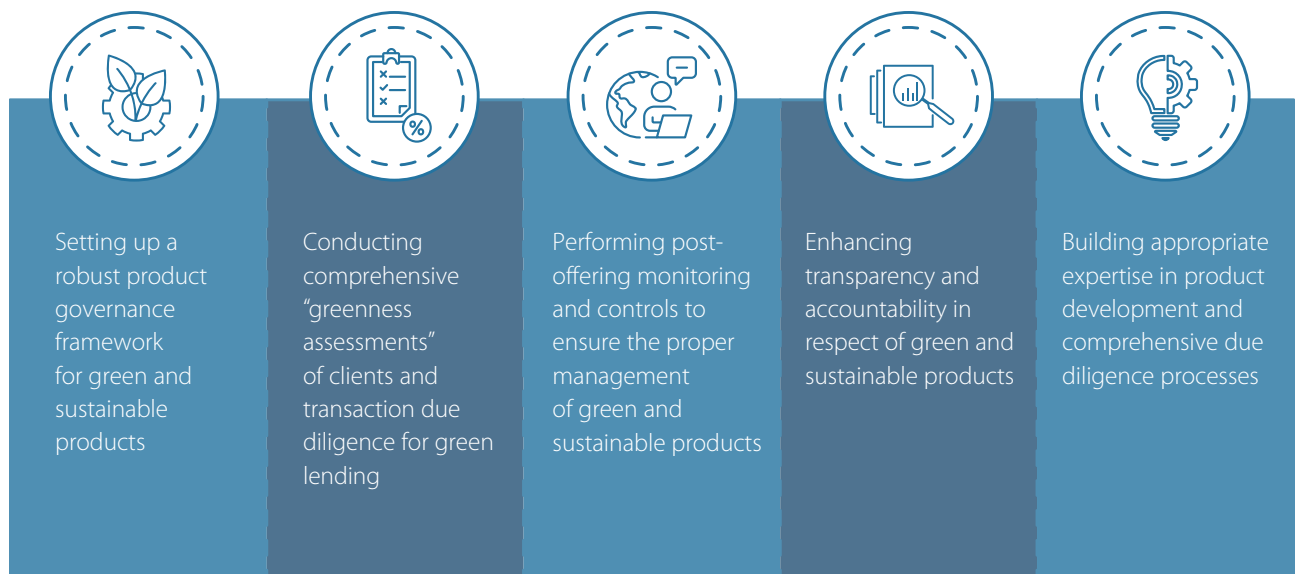
Under the two-year plan, the HKMA has also been enhancing the "greenness" assessment framework for banks to reflect the latest developments in relation to sustainability issues including the management of climate risks and transition planning. Meanwhile, the HKMA has been reviewing the Supervisory Review Process conducted for the purposes of evaluating and monitoring the capital adequacy of a bank and determining its Pillar 2 capital requirement, with a view to incentivising banks to enhance their risk management framework to address risks related to climate change and transition to carbon neutrality.

² CAMEL is an internationally recognised framework for assessing the Capital adequacy, Asset quality, Management, Earnings and Liquidity of banks. It can help identify banks whose weaknesses in financial condition, compliance with laws and regulations, risk management systems and overall operating soundness require special supervisory attention.

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Sharing good practices in the development and management of green and sustainable products

In view of the growth in banks' green and sustainable product offerings, the HKMA undertook a round of thematic examinations focused on banks' development and ongoing management of these products. The HKMA identified some good practices over the course of the examinations and issued a circular in December to share with the industry the good practices to facilitate banks to build up their climate risk management capability. These good practices are grouped under five, high-level, principles:



Applying technology in managing risks and enabling sustainable practices

The use of technology can improve data availability and build up banks' capacity in managing climate risks. The HKMA has started developing a common platform for banks to assess the impact of physical risks on real estate. In addition, the HKMA has, in collaboration with other central banks and supervisors, completed a project under the Bank for International Settlements (BIS) Innovation Network to explore how technological solutions can be deployed to assist with physical risk assessments.

The HKMA also prioritises the enabling of sustainable, globally leading anti-money laundering practices, powered by advanced analytical and regulatory technology (Regtech) capabilities supported by fully automated regulatory data collection. In particular, regulatory data collection for anti-money laundering has been streamlined in the last 12 months to reduce manpower burden and paper consumption for banks.

Supporting transition

Developing a green classification framework to facilitate green finance flows

To increase the transparency across financial markets and enable consistent policy making on green finance, the HKMA has been working with other financial regulators to develop a local green classification framework. A green classification framework, commonly known as green taxonomy, classifies economic activities as being green or sustainable and could be used as a reference by authorities and market participants in determining whether an activity or its related product is truly green or sustainable. As part of this effort, the HKMA has been engaging with the industry and other relevant stakeholders to better understand the features and challenges of the framework, and is working towards a consultation on its proposed structure and core elements in the first half of 2023.

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Financial and monetary stability

Cognisant of the potential risks that climate change may pose to the financial system, the HKMA incorporates a broader range of climate related considerations and scenarios into its analysis of financial risks and research studies to enhance its ongoing surveillance efforts.

Integrating climate-related risks into financial stability monitoring

The HKMA takes into account climate change in its ongoing monitoring of financial stability risks, and incorporates analyses of climate-related risks in various financial stability reports. Through its active participation in the Workstream on Scenario Design and Analysis under the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), the HKMA contributes to further enriching climate scenarios for central banks and supervisors in understanding the macroeconomic and financial impacts of climate change.

On the research front, in 2022 the HKMA conducted applied research projects that look deeper into two key topics, namely greenwashing in the corporate green bond markets³; and the role of disclosure in mitigating climate risk exposure⁴.

The findings from these research projects inform the development of policies and regulatory measures in addressing impacts of climate risks on financial stability. Locally, these studies support the HKMA's ongoing monitoring and assessment of financial stability impacts of climate risks. Outside of the HKMA, these findings have also been shared with a wide range of stakeholders via various channels, including international central bank research conferences and the HKMA's *Half-Yearly Monetary and Financial Stability Report*.

Embedding sustainability considerations in the Liquidity Facilities Framework

The HKMA's Liquidity Facilities Framework serves as a collateral-based backstop source providing timely liquidity support to banks in case of need. The HKMA is working on embedding sustainability considerations in evaluating eligible collaterals under this framework.

³ Leung, Wan and Wong (2022) "Greenwashing in the corporate green bond markets", *HKMA Research Memorandum 08/2022*. (<https://www.hkma.gov.hk/media/eng/publication-and-research/research/research-memorandums/2022/RM08-2022.pdf>)

⁴ Leung and Wan (2023) "The role of disclosure in mitigating climate risk exposure", *Hong Kong Institute for Monetary and Financial Research paper*, forthcoming.

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International collaboration

The HKMA plays an active role in international and regional discussions on tackling climate risk and mainstreaming sustainable finance. Through such participation, the HKMA contributes to international and regional policy dialogues in addressing climate change and its impact on financial stability, while gaining insights on strengthening the climate resilience of Hong Kong's financial system.

Central Banks and Supervisors Network for Greening the Financial System

The HKMA is a member of the NGFS, which aims to share best practices and contribute to the development of climate and nature-related risk management in the financial sector, and to mobilise mainstream finance to support the transition towards a sustainable economy. The HKMA participates in NGFS workstreams and task forces relating to supervision, scenario design and analysis, net zero for central banks, and nature-related risks.

Basel Committee on Banking Supervision

The HKMA participates in the work of the Basel Committee's Task Force on Climate-related Financial Risks in developing principles for the effective management and supervision of climate-related financial risks.

Bank for International Settlements Innovation Network

The HKMA participates in the BIS Innovation Network, which explores technological solutions that help banks identify, measure and monitor their exposures to climate risks.

International Platform on Sustainable Finance

Jointly with the Securities and Futures Commission, the HKMA represents Hong Kong in the International Platform on Sustainable Finance, which has introduced the Common Ground Taxonomy and has been working to promote transition finance.

Financial Stability Board

The HKMA actively participates in the work of the Financial Stability Board (FSB) on climate risk management, including promoting climate-related disclosures and reviewing regulatory and supervisory approaches to addressing climate risk.

The HKMA is a member of the FSB's Climate Vulnerabilities and Data Working Group, which has been analysing and developing tools for monitoring climate-related vulnerabilities at cross-sector and cross-jurisdiction levels.

Executives' Meeting of East Asia-Pacific Central Banks

The HKMA is a member of Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which focuses on sustainable finance as one of its strategic priorities. The HKMA is the Champion of the Interest Group on Sustainable Finance of EMEAP's Working Group on Banking Supervision, and leads studies that aim to promote information sharing on various aspects of climate risk management, such as green classifications and climate risk stress testing.

The HKMA also chairs EMEAP's Working Group on Financial Markets, which recently finalised a project to promote investment in green bonds through the Asian Bond Fund initiative.

International forums on climate-related issues

The HKMA contributes to international discussion on climate-related issues in various forums including the Committee on the Global Financial System's Workshop on "Climate Risks and Asset Prices" and the 14th Annual Workshop of the Asian Research Network co-hosted by the BIS and the Bank of Korea.