**Annex**

## Good practices on transition planning

In Q4 2023, the HKMA conducted the second round of greenness assessment, in which we surveyed 38 AIs (hereafter called "participating AIs") on their transition planning practices. Participating AIs comprise locally incorporated AIs and Hong Kong branches of banks incorporated outside Hong Kong. 40% of participating AIs are from the Mainland (i.e. their parent group or headquarters are located in the Mainland), 8% from Hong Kong, 18% from the rest of Asia-Pacific, 29% from Europe and 5% from the Americas. The survey covered the key elements of governance, implementation strategy, engagement strategy, metrics and targets, data collection and processing, scenario analysis, and disclosure and communication. This annex summarises the key observations and good practices identified by the HKMA through the survey.

It should be noted that local subsidiaries or branches often rely on the transition planning conducted at the group level. As such, "participating AIs" in this annex may not always refer to the AIs themselves, but to the banking groups to which they belong.

### A. Governance

***Roles, responsibilities and oversight***

Key observations

The board and senior management of the majority of participating AIs have been tasked with overseeing the AIs' transition planning, including approving transition plans. Most participating AIs have established dedicated governance bodies to oversee the risks that they face due to the net-zero transition and oversee the implementation of the AIs' transition plans.

Good practices

1. **Strengthening the governance structure for overseeing transition planning and developing and implementing transition plans**

    - The majority of participating AIs have expanded the board's and senior management's roles and responsibilities to explicitly cover transition planning and established dedicated committees at the group level to support the oversight of the AIs' transition planning. These committees maintain regular communication with the Hong Kong offices to ensure that local operations are aligned with the group's transition strategy. Some participating AIs have formed regional or local committees to support the development and implementation of transition planning in Hong Kong.

2. **Ensuring robust oversight of net-zero transition strategy and integration of net-zero targets into business strategy**

- At many participating AIs, the board and board-level committees oversee the integration of transition planning processes into business strategies, with the senior management playing an active role in overseeing transition efforts. This helps to ensure that net-zero transition topics are prioritised and embedded at the board level and that strategies are effectively implemented and aligned with organisational goals.

- The majority of participating AIs have established regular reporting mechanisms to keep senior management and board-level committees informed and up-to-date about progress on transition planning. For instance, the board and senior management or designated committees of some participating AIs receive regular updates on the progress in meeting net-zero targets and review metrics to ensure that risks associated with the net-zero transition are considered in the risk management framework. One participating AI highlighted that it has a governance committee that is tasked with reviewing all transition-labelled transactions to reduce potential transition-washing risk.

***Skills and culture***

<u>Key observations</u>

Many participating AIs are promoting cross-functional collaboration in executing their transition strategy and supporting clients' transition. Participating AIs are investing in or providing regular and targeted training programmes in transition planning for their board members, senior management and staff.

<u>Good practices</u>

3. **Enhancing collaboration in transition planning across functions and divisions**

- Some participating AIs are promoting a collaborative approach to ensure that all relevant business functions or divisions have adequate involvement in transition planning matters. For example, some participating AIs have established cross-departmental working groups to promote coordinated collective actions towards the AIs' climate or transition objectives. Some of the working groups are headed by C-suite officers across the risk, finance and executive functions and comprise members from across business lines and levels, so as to facilitate internal communication and collaboration and cultivate a culture of embedding climate or transition considerations within the AIs.

4. **Enhancing staff knowledge and capabilities to support effective transition planning**

- Some participating AIs have implemented comprehensive training programmes in topics related to transition planning, through establishing internal training academies and offering online courses. Targeted training is provided for the board, senior management, and staff involved in transition planning. Some participating AIs collaborate with universities to offer tailored professional certificate courses for their staff. These initiatives enhance staff knowledge and capabilities to support effective transition planning.

## B. Implementation Strategy

### *Products and services*

Key observations

The majority of participating AIs, even those that have yet to formally commence transition planning, are currently offering green or sustainability-related products to clients. A range of green financial products, including green bonds, sustainability-linked loans, green deposits and investment funds, are being provided by the AIs to cater to the diverse needs of different clients. Some participating AIs continually refine their green products and services in response to customer feedback.

Good practices

**5. Offering a diverse range of green and sustainable products to cater to the needs of different clients**

- To support clients' transition needs and achieve their net-zero targets, many participating AIs offer a wide range of green and sustainable products through underwriting, direct lending and distribution of third-party products. These products include green bonds, sustainability-linked loans, green mortgages, green deposits, green trade finance, green investment funds, and carbon credits.

- Depending on their business strategies and client base, different participating AIs adopt different approaches to addressing the green or transition financing needs of different types of clients. For instance, some participating AIs offer tailor-made deal structures for corporates or project financing, whilst some provide green deposits to retail customers. In designing green or transition products, while some participating AIs focus on the use of proceeds, others structure the products in ways that provide incentives for their clients to meet climate goals.

- Apart from underwriting green bonds, some participating AIs actively support both corporates and governments in green bond issuance and distribution. This can help to build a more comprehensive green and sustainable finance ecosystem in Hong Kong.

**6. Adopting internationally-recognised standards and taxonomies for green product classification**

- Some participating AIs develop green or transition products in line with international standards and principles, such as those issued by the International Capital Markets Association, the Climate Bonds Initiative, or the Loan Market Association. They also align their products with widely used taxonomies, including the EU Sustainable

Finance Taxonomy.[1] Where an internal taxonomy is used, it is often developed based on widely accepted taxonomies. Some participating AIs seek third-party green certification and select certification providers by referring to the Recognised External Reviewer List under the Green and Sustainable Finance Grant Scheme.

**7. Providing advisory and support services to facilitate clients' transition**

- While the real economy's net-zero transition poses risks, it also presents new business opportunities for AIs. Participating AIs which are more advanced have a dedicated ESG or sustainability expert team to explore new opportunities in transition finance that align with their climate ambitions, provide advisory services to their corporate clients on decarbonisation levers and/or structure tailor-made solutions to meet their clients' specific needs. One participating AI highlighted that although providing advisory services is not traditionally part of a bank's services or responsibilities, it facilitates the AI's exploration of business opportunities and understanding of clients' transition strategies.

***Policies and activities***

<u>Key observations</u>

The majority of participating AIs have embedded climate risk considerations in their lending/financing policies and business activities, such as credit approval process, especially for some high-emitting sectors such as energy, power and oil and gas. For example, many participating AIs have decided not to finance new coal-fired power plants and will phase out existing exposures gradually. Some participating AIs incorporated such consideration more systematically in their decision-making process and have developed their own analytical tools to assist in making credit/investment decisions.

<u>Good practices</u>

**8. Implementing a set of lending/financing policies on high-emitting sectors**

- Many participating AIs have implemented lending/financing policies on a few high climate risk sectors, taking into account various factors such as the AIs' transition goals and portfolio exposures, government policies and sectoral decarbonisation trajectories. Some of them have published a divestment policy to exclude or stop financing to clients or sectors that do not align with the AIs' targets, such as thermal coal, as a way to demonstrate a clear commitment to net zero. Such divestment is usually conducted in a gradual manner, so as to avoid abrupt changes which would not be conducive to a smooth transition.

- Some participating AIs engage with local teams in different jurisdictions when setting policies at the group level, and provide room for regional model implementation.

[1] Participating AIs were asked to complete the survey based on their position as at 30 June 2024. As such, it was unlikely for their responses to include measures or actions that took into account the Hong Kong Taxonomy for Sustainable Finance which was published on 3 May 2024.

**9. Embedding climate and transition considerations across a wide range of business activities**

- Many participating AIs have embedded climate or transition targets into their risk management processes, and a few of them extend such practices to a broad range of business activities and operations, including due diligence, credit assessment, loan management and monitoring, supply chain management (such as in the AIs' service procurement) and staff performance.

**10. Allocating sufficient resources, such as human and IT resources, to transition planning**

- The data and methodologies needed for transition planning may not be readily available or sufficiently mature, and AIs need to find alternative ways to collect data, assess their transition progress and identify new business opportunities. All these require human and IT resources. Some participating AIs have developed green rating tools to assess the ESG score of individual green product transactions (such as green loans) by analysing their potential ESG impact. Participating AIs which are more advanced dedicate resources to analysing their clients' transition plans to identify financing opportunities. A few participating AIs enhanced their IT infrastructure to collect relevant data on their clients' exposure to climate risks and alignment with the AIs' goals, so as to facilitate data-driven lending decisions.

## C. <u>Engagement Strategy</u>

<u>Key observations</u>

The majority of participating AIs, including those which are just beginning to consider transition planning, are enhancing client engagement and participating in relevant industry initiatives. As mentioned above, advanced participating AIs often offer advisory services to assist clients in executing their transition strategies effectively. In addition, they are stepping up their engagement with a diverse range of stakeholders beyond their clients, so as to foster collaboration among different groups of stakeholders and promote a comprehensive approach to the net-zero transition.

<u>Good practices</u>

**11. Stepping up engagement with clients to understand their transition strategies and the impacts of the strategies on AIs' transition planning**

- Some participating AIs are adopting proactive approaches to understanding and supporting their clients' transition, particularly clients that are in high-emitting or hard-to-abate sectors. Apart from providing advisory services as mentioned above, they have developed standardised tools to collect information on clients' transition plans or strategies, for example through the use of structured questionnaires or assessment tools, and established processes to understand their clients' transition progress and determine whether any follow-up is needed (e.g. agree with the clients on remedial actions, limit maturities, etc). Some participating AIs have committed resources, such as establishing knowledge hubs, to provide clients with the data and expertise necessary to navigate the transition.

**12. Collaborating with various stakeholders to advance transition planning**

- Many participating AIs are engaging with industry associations or have joined industry-led initiatives (e.g. the Net Zero Banking Alliance) in order to contribute to the development of industry standards or principles and/or to keep abreast of the latest developments in transition planning. Advanced participating AIs go a step further and engage with a wider group of stakeholders, such as government departments, non-governmental organisations and universities, which allow them to gain insights into policy change, technology development and sectoral decarbonisation pathways.

## D. Metrics and Targets

Key observations

The majority of participating AIs have set targets to guide their transition, with the most common type of target being net-zero targets, both for the AIs' own operations and financed emissions. For financed emissions, a sectoral approach is often employed, with the most common sectors being power, oil and gas, coal, iron and steel, and automobile. Another common type of target is green or sustainable financing targets. Almost half of the participating AIs have pledged not to finance any new coal-fired power plants or projects.

Good practices

**13. Using different types of metrics and targets for the short, medium and long term to guide the AI's transition and monitor progress**

- Advanced participating AIs make use of a range of metrics and targets (i.e. not just net-zero or decarbonisation targets) over the short, medium and long term to guide their transition planning and manage climate-related risks and opportunities. Examples of such metrics and targets include green or transition financing, exposure to high-emitting sectors, exposure to high physical risk, etc.

- Many participating AIs conduct annual reviews to ensure that their targets and transition planning processes remain relevant, effective and aligned with strategic objectives.

**14. Aligning portfolios with Paris Agreement goals and science-based pathways**

- Participating AIs that have set sectoral decarbonisation targets often make use of science-based pathways that are aligned with a 1.5°C warming scenario to benchmark their sector portfolios. Such pathways are provided by well-recognised bodies such as the International Energy Agency (IEA). One participating AI mentioned that it uses a comprehensive dashboard to provide and monitor an overview of the decarbonisation pathways (provided by scenario developers) that it has used to benchmark different sectors and regions of its portfolio. Some participating AIs highlighted the importance of monitoring the latest developments around methodologies and sectoral decarbonisation pathways and adjusting sector baselines and trajectories as necessary.

## E. Data Collection and Processing

Key observations

Many participating AIs commented that there are still obstacles and challenges to obtaining good quality data for transition planning, but advanced participating AIs have made significant efforts and attempts to overcome the difficulties and make the best use of what is available.

Good practices

**15. Enhancing data governance frameworks to improve data management and adapting systems to collect and distribute climate-related data**

- Advanced participating AIs have established a climate or ESG data strategy to enhance data management and streamline data collection. There is often a defined governance structure for implementing the data strategy. For example, the strategy may be overseen by the Chief Sustainability Office or even a dedicated Chief Data Officer. A few participating AIs set up cross-departmental working groups to bring together relevant staff to collaborate on solving data issues.

- A climate or ESG data strategy typically comprises the elements below:

  - defining criteria for good quality data, for example criteria around data coverage, collection or modelling method, and frequency of review;

  - developing a data sourcing strategy. The majority of participating AIs use a range of data sources, such as government data, industry-recognised databases and data vendors. A few participating AIs have gone further and are exploring partnerships with universities to broaden their data sources; and

  - enhancing the data collection and management systems, such as building centralised platforms that automate the collection of internal and external data (including data collected from clients through the structured questionnaires mentioned in paragraph 11 above) and embed the data into workflows across the AIs' functions and businesses.

  It should be highlighted that even for some participating AIs which do not have a climate or ESG data strategy per se, they are carrying out one or more of the above measures.

- A few participating AIs are leveraging technology to plug data gaps. For example, two participating AIs are exploring the use of advanced analytics such as document scraping and remote sensing.

**16. Ensuring data credibility through periodic reviews and third-party verification**

- To check whether the data they source are credible, many participating AIs rely on third-party verification. In the case of data collected from clients, some participating AIs ask their clients to provide a second-party opinion or third-party verification. One participating AI makes use of a range of additional controls such as conducting (a) ad hoc verification of data on the largest clients by the first and/or second lines of defence, (b) impact analyses when datasets are updated by the providers, and (c) sanity checks (e.g. comparing the average emission intensity of the data provider's dataset against the average sectoral value obtained from independent sources such as industry bodies).

- Participating AIs highlighted the importance of conducting periodic data reviews, for example through checking for updates to scenarios and advancements in emission measurement methodologies and asking clients to review and update their responses to climate risk questionnaires every year. Such periodic reviews allow participating AIs to assess whether there are any significant changes to their input data and assumptions which may warrant adjustments to the AIs' targets.

## F. Scenario Analysis

Key observations

The majority of participating AIs have conducted climate scenario analysis, primarily for risk identification and conducted through participating in supervisor-driven climate risk stress tests (CRST). Some participating AIs apply scenario analysis to determine the alignment of their portfolios to the sectoral pathways provided by scenario developers and derive their sectoral decarbonisation targets for high-emitting sectors or sectors to which they have significant exposures.

Good practices

**17. Applying different climate scenarios for different purposes**

- For risk management purposes, many participating AIs adopt the NGFS[2] scenarios to identify and assess transition risk in their portfolios, as these scenarios tend to focus on macroeconomic impacts. The IPCC[3] scenarios are used for physical risk assessment as they are based on climate modelling.

- For target setting, many participating AIs use IEA scenarios, which focus on energy transition and use carbon price assumptions as an input factor, to derive sectoral targets for energy sectors. Some participating AIs also select other sector-specific scenarios, such as the CRREM[4] scenarios for the real estate sector. Despite using different scenario providers, participating AIs often choose scenarios with a common goal which aligns with the AIs' targets, such as net zero by 2050.

[2] Central Banks and Supervisors Network for Greening the Financial System
[3] Intergovernmental Panel on Climate Change
[4] Carbon Risk Real Estate Monitor

- Having gained experience in scenario analysis, for example through CRST, a few advanced participating AIs have developed bespoke scenarios that can help identify idiosyncratic risks specific to the AIs' businesses and vulnerabilities.

**18. Incorporating the results of scenario analysis into risk management processes and updating the analysis regularly**

- Some participating AIs have incorporated the results of their scenario analysis, including those from CRST, into their risk appetite, Internal Capital Adequacy Assessment Process and internal climate risk management framework.

- As mentioned above, many participating AIs check for updates to scenarios regularly. This allows them to update their scenario analysis once scenario developers update the global data and forecasts that serve as input to the scenario models.

**19. Building up internal capabilities to conduct scenario analysis**

- Some participating AIs that rely on the scenario analysis conducted by the head office have local teams to support the assessment of the local branches. For participating AIs that engage data vendors, they endeavour to understand and compare the data quality and proxy methodologies before procuring the services of those vendors. Other participating AIs request consultants to provide skill transfer to build up the AIs' internal capabilities.

- Based on the HKMA's observations from discussions in the international central banking and supervisory community, AIs are advised to conduct analysis on a wide range of scenarios, given that there is uncertainty around any particular scenario materialising and that different portfolios may be exposed to different risk drivers with the associated risks manifesting in different situations. AIs can compare how particular portfolios are impacted under different scenarios and assess the sensitivity of the portfolios to certain risk drivers.

## G. Disclosure and Communication

Key observations

Many participating AIs are keeping both external and internal stakeholders informed of the AIs' transition planning activities or transition plans, including their progress in implementing those activities or plans. They often rely on industry-recognised methodologies (e.g. PCAF[5] Standards) and frameworks (e.g. TCFD[6]) to calculate emissions and disclose their transition plans or transition planning information.

[5] Partnership for Carbon Accounting Financials
[6] Task Force on Climate-Related Financial Disclosures

Good practices

**20. Enhancing transparency around transition planning through both external and internal channels**

- Some participating AIs have published information about their transition planning, including reporting annually on their progress in meeting committed targets. Such information is usually published either as a standalone transition plan or as part of their sustainability/ESG reports and in accordance with recognised frameworks such as TCFD. In addition, some participating AIs have engaged with external parties such as government agencies, non-governmental organisations and financial and non-financial industry bodies to enhance the AIs' knowledge of climate-related issues and to facilitate stakeholders' understanding of the AIs' transition plans and initiatives.

- As for internal communication, many participating AIs keep their staff informed about their transition plans, goals and progress through channels such as training sessions, town halls, newsletters, resource centres and corporate portals. One participating AI mentioned that its head office produces podcasts and videos to provide updates to both internal and external stakeholders on the AI's targets and plans.