

HKMA Circular: Embedding climate risk in banking supervision



July 2022







On 30 June 2022, the Hong Kong Monetary Authority (HKMA) published a new circular¹ that sets out its two-year plan to integrate climate risk into its banking supervisory processes. In this brief, KPMG outlines HKMA’s key initiatives and how they may impact regulatory enforcement and oversight in the coming year.

A new Supervisory Policy Manual (SPM) module GS-1 “Climate Risk Management” was introduced by the HKMA in December 2021. This SPM sets out HKMA’s supervisory expectations for authorized institutions (AIs) to incorporate climate risk considerations into their current strategies and frameworks. In the same month, HKMA also shared 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, the HKMA has now completed a comprehensive review of its existing supervisory processes and developed a two-year plan to incorporate climate risk considerations into these processes.

Understanding these processes allow AIs to adjust their climate strategies correspondingly to meet regulatory expectations.

HKMA Key Initiatives	KPMG’s views on next steps for AIs
<p>Prudential Meetings</p> 	<ul style="list-style-type: none"> Climate risk management is included as a standing item of prudential meetings for the next two years HKMA will check on AIs’ progress in addressing climate risks, including their compliance with the new SPM GS-1 and adoption of the measures in the HKMA’s circular of “Sound practices supporting the transition to carbon neutrality” <ul style="list-style-type: none"> AIs are recommended to have solid plans and frameworks prepared in advance of the prudential meeting Management should have in-depth understanding of climate risk related measures to facilitate better discussions with HKMA
<p>Update CAMEL framework</p> 	<ul style="list-style-type: none"> HKMA updated the CAMEL rating framework and the SPM Module SA-1 on “Risk-based Supervisory Approach” These enhancements will be worked out in second half of 2022 to ensure sufficient emphasis is accorded to climate risk management by HKMA supervisors <ul style="list-style-type: none"> AIs should consider how climate risks are incorporated into the ERM framework, and how climate risks could possibly affect CAMEL rating through the 8 inherent risks set out in SPM SA-1 Risk management systems and controls should be established to address climate risks

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Thematic Examinations 	<ul style="list-style-type: none"> • Thematic reviews will be conducted in the second half of 2022 to assess the due diligence processes of AIs for green and sustainable products • Another round of thematic reviews is planned to commence in 2023, focusing on climate related risk governance, after the 12-month implementation period for achieving compliance with the new SPM module GS-1 on “Climate Risk Management” has lapsed 	<ul style="list-style-type: none"> • Revisit end to end processes for green and sustainable products, with focuses place on due diligence processes. Mechanisms could be established to mitigate and manage green washing risks • Review climate risk related governance, and compare current mechanisms in place to regulatory requirements to ensure regulatory compliance
Stress Test 	<ul style="list-style-type: none"> • HKMA is refining its approach to evaluating the overall climate resilience of the banking sector • Another round of climate risk stress test is intended to be conducted 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 	<ul style="list-style-type: none"> • Reviews should be performed to ensure all necessary data are captured for scenario analysis. Data capture processes could be improved, or use of proxies can be considered • Calibration of existing model and assumptions of scenarios could be reviewed to take into considerations of current market trends and developments
Enhancement of Framework 	<ul style="list-style-type: none"> • HKMA is reviewing the “greenness” assessment 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 2022, based on the revised assessment framework 	<ul style="list-style-type: none"> • Continue to explore how climate risks affects risks and businesses, and identify factors that might be unique to each AI and take measures to address the issues
Review Regulatory Framework 	<ul style="list-style-type: none"> • HKMA is currently considering incorporating climate risk into its Supervisory Review Process (i.e. Pillar 2 of the Basel regulatory capital framework) • HKMA will closely monitor international discussions on refining the minimum capital requirements under Pillar 1 and the disclosure requirements under Pillar 3 to address climate risks 	<ul style="list-style-type: none"> • If the HKMA incorporates client risk into the Supervisory Review Process, AIs will need to update their Capital Adequacy Assessment Process to incorporate climate risk

KPMG is working with financial institutions in Hong Kong to help them address the impact of evolving market conditions and regulatory requirements. Our Risk and Technology Consulting teams can advise across all areas of the regulators' agenda, including:

1

Implementation of HKMA's regulatory requirement, HKMA SPM GS-1 and relevant circulars

2

Implementation of climate risk stress test framework and establishment of climate risk scenario settings

3

Establish disclosure reporting framework aligned with Task Force on Climate-Related Disclosures (TCFD) recommendations

4

Organise climate risk training sessions and provide relevant materials, which cover local and global trend of climate risk management and regulatory requirements

References

¹ *Hong Kong Monetary Authority, Embedding climate risk in banking supervision, June 2022, <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220630e1.pdf>*

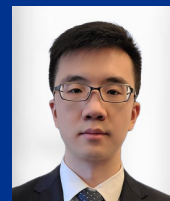
Contact us



Pat Woo
Partner, Head of ESG
Global Co-Chair, Sustainable Finance,
KPMG IMPACT
KPMG China
T: +852 3927 5674
E: pat.woo@kpmg.com



Gemini Yang
Partner, Financial Risk Management,
KPMG China
T: +852 3927 5731
E: gemini.yang@kpmg.com



Mo Liang
Associate Director, Financial Risk
Management,
KPMG China
T: +852 3927 3108
E: mo.liang@kpmg.com

home.kpmg/cn/socialmedia



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