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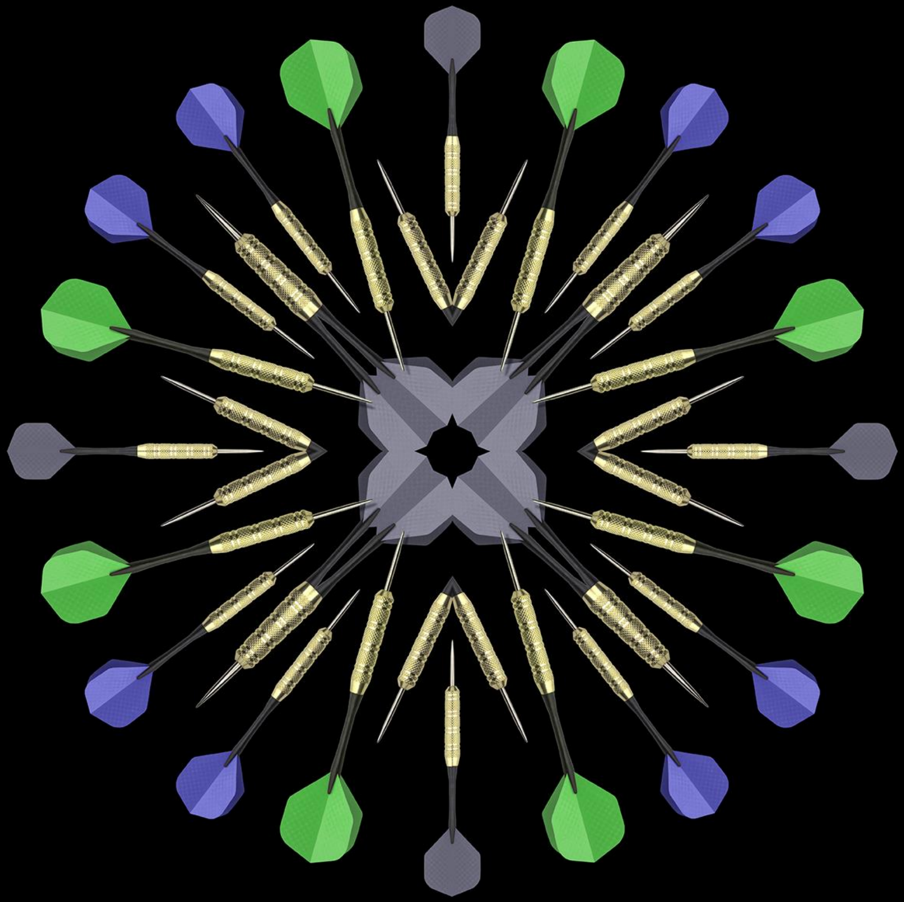


2020 Asia Pacific Financial Services Regulatory Outlook

Rebuilding trust in financial services

January, 2020

CENTRE *for*
REGULATORY STRATEGY
ASIA PACIFIC

Regulatory and Social Licences to Operate

Trust in the financial services industry remains low, despite the higher regulatory standards that have helped bolster public confidence.

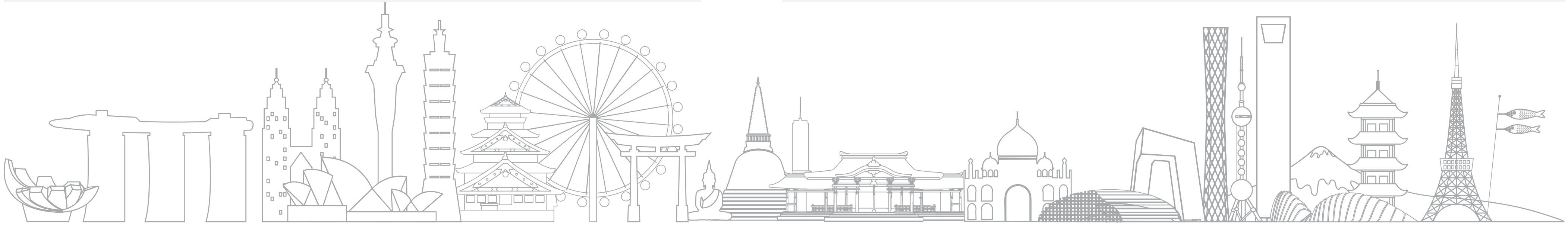
Many of these post-crisis reforms relate to a financial institution's **regulatory** licence to operate - the basic rules and laws within which firms must operate. They are simply what regulators expect of financial institutions.

This begs the question – why does trust in financial services remain so low, even after so much work has gone into strengthening financial institutions’ regulatory licence to operate?

This is because much remains to be done for financial institutions to reclaim their **social** licence to operate.

A social licence to operate relates to building a robust firm culture that drives good behaviour; it also calls for proper governance and accountability within organisations. This means, for example, doing right by customers by properly protecting their personal data and using it ethically as inputs into emerging technologies like artificial intelligence. Finally, it lays out the need to forge stronger communities and societies through forward-looking endeavours like financial inclusion and sustainable finance.

In our 2020 *Outlook*, we explore how Asia Pacific regulators will focus on these aspects of financial institutions’ social licence to operate in the coming year. We look at how this will impact firms’ internal operations, how they harness technology, how they engage with their customers and society as a whole, and what firms need to do to meet these challenges.



Evolution of International Reforms - market fragmentation

Asia Pacific is particularly vulnerable to market fragmentation when global reforms are translated to the national level.

The final revisions to the Basel III package were published in December 2017 with an implementation date of 1 January 2022. Previous experience with delayed and uneven implementation, despite the best faith efforts of member jurisdictions, creates uncertainty about the timing and consistency for implementing the final reforms.

Market fragmentation is particularly relevant to Asia Pacific due to its large number of Basel member jurisdictions. The Japanese presidency of the G20 made market fragmentation a specific point of inquiry to which the Financial Stability Board (FSB) published a report in June 2019 as a response. The FSB report notes that some forms of market fragmentation may be beneficial as differing regulations between jurisdictions can "reduce the transmission of economic shocks between jurisdictions, and increase the resilience of domestic or global financial markets". However, detrimental market fragmentation that reduces global and domestic financial stability, impairs market liquidity, and encourages regulatory arbitrage is also a specific concern.

Progress in implementing standards with passed deadlines as of end of March 2019

	Deadline	# of Member jurisdictions with draft or final rules	Basel Committee on Banking Supervision (BCBS) Asia Pacific jurisdictions without draft or final rules
Total Loss-Absorbing Capacity holdings (TLAC)	1 January 2019	19 of 27	Australia, Mainland China, India, Indonesia, Korea
Large Exposure Framework (LEX)	1 January 2019	24 of 27 (only 9 are final rules)	Japan
Interest Rate Risk in the Banking Book (IRRBB)	1 January 2019	23 of 27	Australia*
Net Stable Funding Ratio (NSFR)	1 January 2018	26 of 27 (only 11 are final rules)	

Source: BCBS

*Pillar I update in progress – draft Prudential Standard APS 117 published in September 2019

Evolution of International Reforms – new areas of supervision

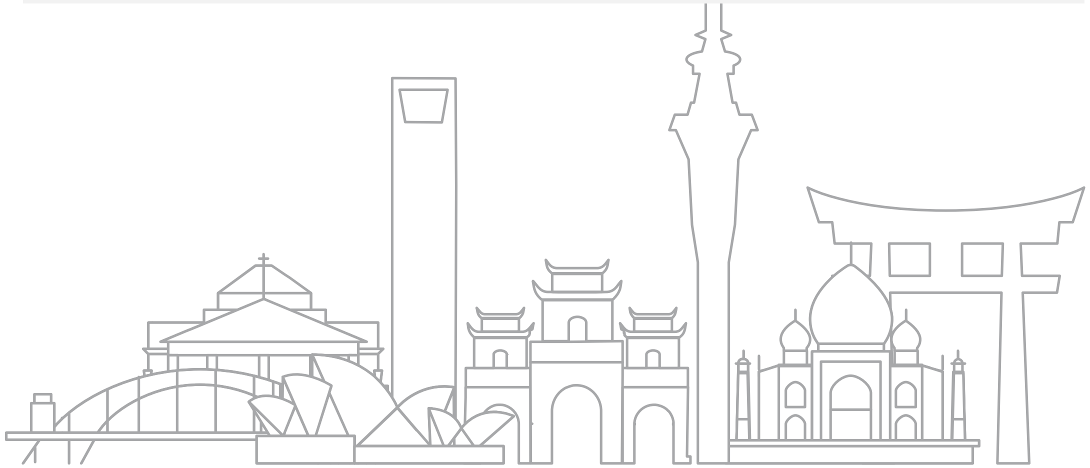
International regulatory bodies have shown an increased interest in how emerging risks will impact global financial stability. The growth of financial technology (fintech), operational resilience, as well as the mitigation of risks related to climate change have been points of recent discussion. These topics will be important for 2020 and beyond.

New Areas of Risk and Supervision

- **Crypto-assets:** Currently the crypto-asset market is relatively small and banks have limited direct exposures. However, as crypto-assets are not a fiat currency backed by a government, the BCBS considers such assets “unsafe to rely on as a medium of exchange or store of value”. The BCBS encourages firms to exercise due diligence, to have proper governance and risk management, and to work closely with local supervisors on the topic.

- **Mitigating the financial impact of climate change:** An emerging issue for global regulatory bodies. The 2019 Status Report of the Task Force on Climate-related Financial Disclosures (TCFD) found that while disclosure of climate-related financial information has increased, it is still insufficient for most investors. Reported data is often not standardised, rarely comparable, which therefore makes it difficult to integrate into investment decisions. As well, companies do not often disclose the scenarios they used to test their resilience to climate change. More clarity of the potential impacts of the risks related to climate change is certainly needed.

- **Operational resilience:** The BCBS lists operational resilience as one of the last remaining policy initiatives that require finalisation in their current work programme. UK financial regulators (the Bank of England, the Prudential Regulatory Authority, and the Financial Conduct Authority) released a joint working paper on operational resilience in July 2018. They listed several key takeaways for senior management: assume disruption will occur, focus on the resilience of their firm's most important business services, set impact tolerances, and test the ability to plausibly stay within those tolerances. All three UK supervisors published a series of consultation papers on operational resilience on 5 December 2019.



Evolution of International Reforms - conclusion

The implementation of the final Basel III package of reforms will be challenging for firms in our region given that most will have operations in multiple jurisdictions. The likelihood of delayed or uneven implementation may also exacerbate market fragmentation against which firms will need to remain vigilant. International supervisory bodies are also turning their attention away from the Basel III reforms and towards other topics like crypto-assets, operational resilience, and mitigating the risks associated with climate change.

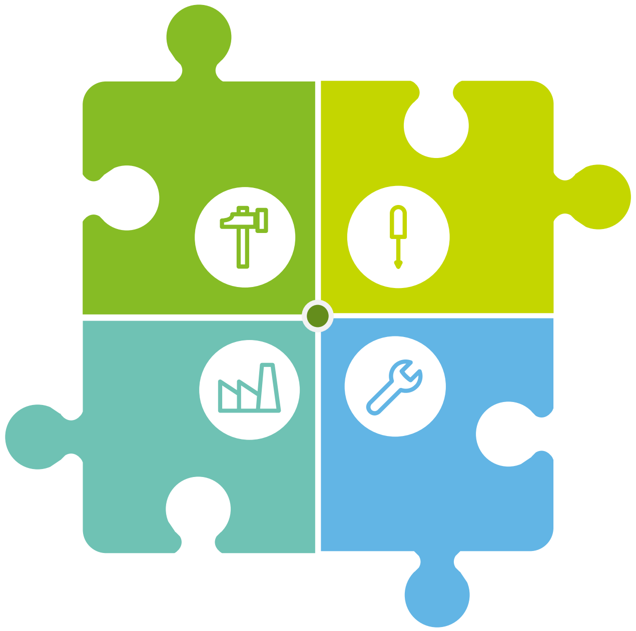
Key Takeaways

Prepare

Prepare to implement the Basel III final rules in line with their home regulators' implementation schedule.

Enhance

Enhance internal risk management for the risks not captured by the Basel international standards. This includes so-called non-financial risks.



Monitor

Monitor the implementation plans in their host jurisdictions, which could deviate from their home regulators' timeline.

Address

Address new regulatory requirements as they begin to emerge, such as those associated with climate change or crypto-assets.

Conduct and Culture – an ongoing conversation

High-profile market misconduct incidents, significant regulatory activity both regionally and globally to address structural governance issues, and low consumer trust have ensured that culture and conduct never fall off the "to-do" list. Getting culture right – and thereby driving good conduct, has always been difficult; it remains so.

The results of the Royal Commission have **kicked off a conversation in Asia Pacific about supervisory approaches to conduct.** Australian Prudential Regulation Authority (APRA) Chair Wayne Byres noted that the prudential regulator was being asked to do more than was traditionally done,

> *"[t]he lessons from the Royal Commission will also require us to review and strengthen our governance (CPS510) and risk management (CPS 220) standards. We will need to devote substantially more supervisory resources to these issues and they will need to become a core competency, just as much as bank capital and liquidity."*

Perhaps the greatest outcome of the Royal Commission was not in the recommendations of the report itself, but the ushering in of a new paradigm characterised by more stringent and proactive supervision, higher community expectations, and a renewed focus on core services through progressive simplification and demerging.

We found that there was a general trend in regulators in Asia Pacific looking towards the events in Australia to draw lessons. This was particularly the case in places like New Zealand or Singapore and more muted in Japan. In all cases there was an interest in improving their own approach to and skills in supervising culture.

Conduct and Culture - conclusion

We believe that, while it will be important to look to themes that are emerging in jurisdictions like the UK, many areas in Asia Pacific will need to continue to look to more fundamental actions.

Emerging trends from outside Asia Pacific

Purpose – Looking beyond the mission statement of a firm to see what a firm is trying to achieve in practice.

"Tone from Above" – Acknowledging the limitations of "tone from the top" as most employees take their cues on culture and conduct from their immediate managers rather than senior executives or board members. There will be growing interest to see that those in management functions at all levels of an organisation are able to reflect and promote key messages from senior management.

Diversity and Inclusion – Who makes up the board and senior management, and who dominates conversation, matters. Regulators are increasingly interested in seeing challenge and rigorous debate, something which is better facilitated by a group with diverse thought and background. This is not only important for top levels of an organisation, but throughout a firm.

Open Communication – Creating a culture where employees feel able to share opinions or admit errors without fear of retaliation or overreaction is what allows issues from the lower levels of an organisation to flow back up to higher levels. Fear-based suppression of misconduct keeps boards in the dark and limits the ability to understand and assess what is really going on at the front lines of a business.

Key Takeaways

Fundamental actions that continue to be relevant to Asia Pacific

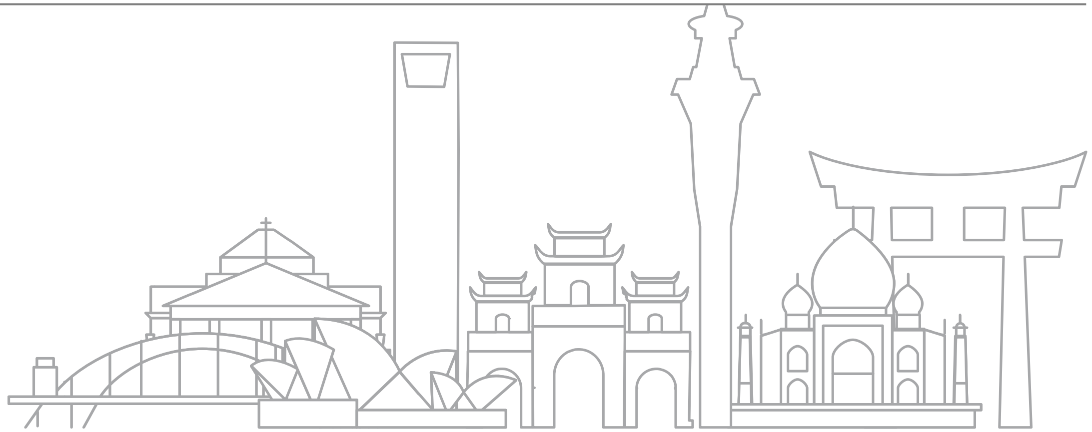
- **Articulating** conduct risk into a firm's larger risk appetite framework;
- **Securing** board and senior management commitment to managing conduct and ensuring that it is aligned with the firm's business model and strategy;
- **Continuously assessing** the effectiveness of managing conduct through point in time surveys, benchmarking, in-depth interviews, and other granular communication; and
- **Collecting** information about the approach of regulators to misconduct cases both in Asia Pacific and abroad to learn how to better avoid similar situations.

Governance – individual accountability regimes

In Asia Pacific, there has been a great deal of regulatory activity to improve governance structures. The region, for example, has three different individual accountability regimes – those currently in effect in Australia and Hong Kong SAR and one announced in Singapore. In this sense, Asia Pacific firms and regulators have been important voices in the global conversation on governance.

Australia **Banking Executive Accountability Regime (BEAR)**	**Hong Kong SAR** **Manager-in-Charge Regime (MIC)**	**Singapore** **Individual Accountability and Conduct Guidelines (IAC)**
Introduced in 2018 for large Authorised Deposit-Taking Institutions (ADI) and extended to small ADIs in 2019.	Implemented in October 2017	Guidelines expected to be finalised by end-2019.
Focused on both Directors and senior management who are accountable for specified areas of the organisation.	Focused on senior management.	Covers senior management of the organisation, but also extends to employees as a whole.
Prime focus is on assigning accountability to individuals for core Banking activities.	Assigns and clarifies the accountability of senior management.	Covers not only individual accountability of senior management, but extends to the conduct of employees as a whole, particularly those in material risk functions.

The spotlight in 2019 in Asia Pacific has been on two key areas of governance: accountability of senior managers and directors, and remuneration mechanisms. The growth of senior manager and Board accountability regimes across the region has accelerated, though no two regimes are the same. As such, this may pose challenges to senior management of cross-border firms in 2020.



Governance – conclusion

With heightened expectations on achieving good corporate governance outcomes, there are several trends and themes that organisations will need to adapt to in order to improve the effectiveness of their governance processes.

Key Takeaways

- **Board Performance**: There is an increased focus on the effectiveness of the Board in fulfilling its duties. In particular, Board composition has come under the microscope in regards to community expectations of diversity, independence, and competence. Firms will also do well to assess whether directors with multiple board appointments have the capacity to discharge their responsibilities adequately.
- **Stakeholder approach** : A broadening of the responsibilities of the Board from shareholder returns is already occurring, as regulators focus on the interactions between organisations and their customers and communities. Effective corporate governance in the future will need to consider multiple stakeholders both inside and outside the organisation, and to assess how the company’s mission, vision, and values align to their benefit.
- **Increased use of data**: With the responsibility of Board members increasing along with higher levels of accountability, correcting the information asymmetry between management and the Board has never been more important. Firms will need to ask – what decisions are the Board making and what data are needed to make them?
- **Improved disclosure**: As societal issues move closer to top-of-mind for consumers and directors alike, organisations will be expected to capture their efforts towards these as part of corporate disclosures. Regulators, communities, and investors are seeking more assurance from corporates that these issues are being managed effectively.
- **Beyond the Board, Risk, and Audit**: Corporate governance has traditionally focused on three key parties in facilitating good governance: the Board, Risk & Compliance, and Internal Audit. With the regulatory focus becoming more about conduct failures as opposed to prudential, we will likely see an extension of the remit of corporate governance across the entire organisation to include requirements on management and employees and the effectiveness of corporate culture and conduct.

Privacy and Data Usage – regime fragmentation across the region

Fragmentation of the privacy regimes across the region, despite a certain amount of convergence in key areas, poses a challenge for firms operating across multiple jurisdictions.

While the bulk of major privacy law overhauls have been completed in Asia Pacific, in 2020 we expect to see continued refinements to the various privacy regimes around the region. This is especially so given the impact of the EU's landmark General Data Protection Regulation (GDPR).

Japan, for instance, has a built-in review mechanism to take into account best practices from abroad or changes in technology as the Personal Information Protection Commission of Japan reviews the bill every three years. Similarly, South Korea is looking to make technical updates to its privacy regime to take into account advances in data protection.

Finally, we may also see regulators or governments move towards data localisation, either by requiring a copy of the data to be kept on servers physically located in a jurisdiction or prohibiting data transfers overseas unless certain stringent conditions are met.

Major regulation updates completed – often unifying disparate laws/regulations or fully replacing previous legislation	**Major regulatory updates in progress**
Australia China Hong Kong SAR Japan Malaysia Singapore South Korea Taiwan Thailand	India Indonesia New Zealand

Privacy and Data Usage – data localisation

Cross-border data sharing in the coming years may be significantly impacted the growing trend towards data localisation – governments mandating where and within which borders copies of specific kinds of data should be stored.

India

- Proposed Personal Data Protection Bill in India requires a copy of personal data for Indian citizens to be held within India.
- Cross-border transfers to be approved subject to certain conditions.
- Certain data can be categorised as critical personal data and require that this be processed on servers stored in India.

Mainland China

- The Cyberspace Administration of China held a consultation period from June – July 2019 on their proposed *Measures for Security Assessment for Cross-border Transfer of Personal Information*.
- Highlights from the discussion paper include:
  - **Better distinction between "personal" and "important" data**: Personal data is identifiable data about individuals and entities while important data regarding critical infrastructure and "public interest";
  - **Data transfer**: Data to be transferred abroad must go through a security assessment to determine if transferring the data will impact China's national security, endanger the public, or expose private data. Previously, only Critical Information Infrastructure operators had to undergo this process but now all network operators must undertake the assessment.

Privacy and Data Usage - conclusion

As privacy regimes and customer expectations continue to evolve through 2020 and over the coming year, firms need to take a forward looking approach to privacy.

Key Takeaways

- **Understand the impacts of Asia Pacific's regulatory diversity**: There are a variety of approaches to privacy laws in Asia Pacific; each jurisdiction's laws will have their own rights, duties, and benefits. Regulators in our region will continue to make judgements on what data should be stored locally, and what can be transferred overseas.
- **Be aware of how emerging technologies use data**: As technology continues to develop, how data is used and how privacy is protected will grow in importance. In our region, regulatory maturity will impact the approach and legal frameworks of Asia Pacific jurisdictions and can pose challenges for firms.
- **Privacy by design as default**: Creating trust is critical to a mature data privacy framework. Embracing a top-down approach to ensure holistic personal data protection is key. This ensures that privacy by design is front and centre from the beginning of any project, which will have positive benefits for business and organisational outcomes. This also encourages trust that data will not be misused or shared inappropriately.
- **Be a good steward**: Collecting and keeping only the data you need to, ensuring its accuracy, sharing and using it only in a way that the customer has authorised (for example – determining whether or not secondary use in data analytics has been consented to) are all key aspects to being a good steward of personal data.
- **Explore new techniques to protect data**: Regulators in Asia Pacific have shown interest in regularly reviewing their privacy regimes and updating them to include new approaches to privacy like new data science techniques. Firms should explore these new techniques and adopt as appropriate for their broader needs.
- **Improve talent within the organisation**: The importance of data and new uses for data will only grow in the future. All levels within an organisation will need to have a firm handle on the legal obligations under privacy regimes as well as the ethical uses of any data collected. Top-level executives, especially the COO, will particularly need to have capabilities and the right mind-set in this area.

Artificial Intelligence – the state of play

Emerging technologies and digital transformation are changing the financial services landscape.

Regulators have largely taken a principles-based approach towards the use of artificial intelligence (AI) in order to strike a balance between prudent risk management and innovation. The flexibility this provides will continue to be valued by both regulators and market participants alike.

The variety of applications for data revolve around **three key capabilities**, which **mimic human intelligence**:

- **Visual Recognition** – the ability to identify objects or scenarios and extract meaning, such as classifying identified objects into predefined categories.
- **Speech and Natural Language Recognition –** the ability to communicate with humans by understanding written text (natural language processing (NLP)) and/or creating (natural language generation (NLG)) human speech.
- **Machine Learning** – the ability to identify patterns and update predictions based on new information.

Questions to guide thoughts on the use of Artificial Intelligence

- What new systemic threats and vulnerabilities are regulators anticipating from the adoption of Artificial Intelligence?
- What are regulators expecting of institutions that are moving into production with Artificial Intelligence?
- How are regulators themselves needing to change in order to adapt to a more technologically advanced set of supervised entities?

Artificial Intelligence – regulatory thoughts from Asia Pacific

Regulators around Asia Pacific will have different capabilities regarding the use of advanced cognitive technology and will approach in different ways.

The ability of regulators to effectively supervise the use of artificial intelligence will vary widely across the Asia Pacific region. The Monetary Authority of Singapore (MAS), for example, has a nuanced understanding of the use of Artificial Intelligence and a coordinated approach to improving their ability to supervise its use. They released a set of principles in late 2018 to promote fairness, ethics, accountability and transparency (FEAT) in the use of Artificial Intelligence and Data Analytics:

Fairness
AI-driven decision should be **justifiable** and data inputs and models used in making those AI-driven decisions should be validated regularly for **accuracy and relevancy**, minimizing bias to the individual or group of individual

Ethics
All AI-driven decisions ought to be held to the **at least** the same ethic standards (i.e. Company values, codes of conduct and mission statements) that would applied to any employee of the firm

Accountability
There should be **clear responsibility and ownership** assigned to competent individual over all AI-driven decisions. A stringent approval process governing the use of AI in decision making should be established and affected data subjects should be provided with channels to seek enquiry or request review of AI-driven decisions

Transparency
Considerations should be given to determine **the appropriate level of information** to be disclosed over the rationale behind the AI driven decision-making. Clear explanation over the data type and the consequences of AI-driven decisions should be provided upon request

Regulator Focus Areas

- Is the use of Artificial Intelligence improving the way decisions are made (ex. Transaction monitoring)?
- What data is being used to feed and algorithm, and how is privacy being protected? How is that data changing over time?
- Can the output of an algorithm be understood and assured? How is the algorithm changing over time?
- Is there a usable user-interface that can allow responsible individuals to understand, approve, and take responsibility for Artificial Intelligence use?

Artificial Intelligence - conclusion

In the spirit of prudent risk management and anticipation of regulatory change, the financial services industry will need to respond to AI risks in a pragmatic and controlled manner in 2020 and beyond.

Key Takeaways

Governance: Both tone from the top and tone from above are critical, and a first point of call for organisations should be their Risk Appetite Statement (RAS). A principles-based approach is key to allowing adequate flexibility, and notions of accountability, transparency and ethics should be considered as non-negotiable. Lines of ownership of AI risk should be agreed amongst stakeholders, including through defined escalation channels. Achieving an appropriately diverse structure requires skills unique to AI, which are becoming increasingly difficult to source in an already under-resourced industry.

Technology Implementation Lifecycle: The introduction of an AI solution needs to be managed at multiple stages across the implementation lifecycle. When considering a new solution or use-case, a risk assessment against AI principles should be performed to identify any zero-appetite risks, and elicit appropriate escalations and approvals. Proximity to customers, model explainability, and AI autonomy are key inputs to this first assessment, and the information captured should allow management to make a clear decision as to whether to proceed. During the build phase and prior to go-live, a detailed risk assessment should be performed against the various domains of AI risk, with the implementation of controls assessed.

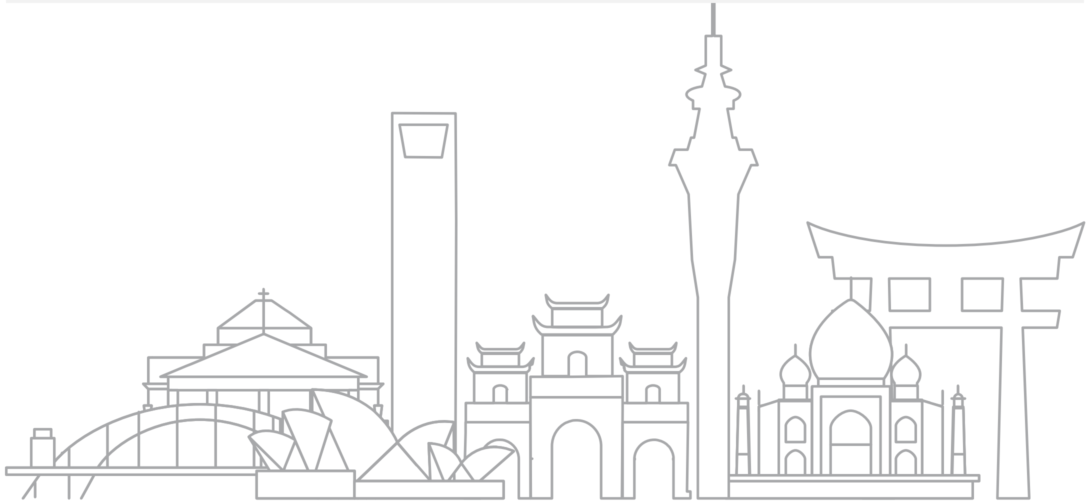
Monitoring and Assurance: AI, particularly when underpinned by machine learning, is a living model and can change significantly over time. In order to ensure a model remains fit for purpose and operates as expected, processes to capture, analyse, and report on model performance should be formalised. Resilience of the underlying platform must also be considered, and regular service continuity testing should be performed, particularly as business knowledge around previous processes begins to fade. Finally, a robust testing program should be developed and performed on a regular basis, underpinned by a comprehensive AI Risk and controls framework.

Financial Inclusion – the democratisation of financial services

Financial inclusion expands access to the financial system through the delivery of responsible, affordable, and accessible financial products and services. It should be understood in broad terms – individuals and small-medium businesses having access to a wide range of financial products and services that meet their divergent needs.

- 2020 marks the end of an ambitious 10 year Group of 20 plan to extend universal access to a bank account. However, 1.7 billion adults across the world still lack access to a bank account.
- The three countries with the largest percentages of the world's unbanked are in Asia Pacific – China at 13% (225 million people), India at 11% (190 million people), and Indonesia at 6% (96 million people). The market size for un – and underbanked individuals is similarly large – the estimated market size for Asia Pacific ranges between US$ 55 billion and US$ 115 billion, including both individuals and enterprises.
- Financial inclusion has been on the minds of regulators for some time – a 2012 World Bank survey of post-crisis regulatory reforms found that 67% of regulators had financial inclusion as a specific mandate. Recent developments include the rollout of digital banking regimes in the region and increased scrutiny on data management and analytics.

- Often already vulnerable populations stand to benefit the most from financial inclusion efforts but the vulnerable groups will vary by background and country.
- Players in the space are often new and non-traditional having entered independently or in partnership with incumbent and/or traditional financial institutions.



Financial Inclusion - different views from around Asia Pacific

While many governments and regulators across Asia Pacific will have financial inclusion on the agenda, their approach, needs of their populations, and desired outcomes are diverse.

China

- 13% of the world's unbanked; 225 million people unbanked
- 2016 digital payments transaction was US$ 17.93 trillion; up to US$ 41.51 trillion in 2018

The Chinese government actively embraces financial inclusion and there has been particular emphasis on using technology.

Technology enabler:

Non-bank digital payments platforms like Wepay or Aplipay.

Japan

- Life expectancy in Japan was 84.2 in 2017
- 2.3% of the population has dementia, expected to be 2.8% by 2037

The Japanese government is particularly concerned about physical and mental limitations or fraud against the elderly inhibiting financial inclusion.

Technology enabler:

AI to detect transaction fraud or mistakes.

Singapore

- 500 million SG$ invested in fintech in 2018
- 31 fintech Co-operation Agreements

Singaporean government initiatives focus on using fintech to expand the range of financial services at home and improve financial inclusion in other parts of the world.

Technology enabler:

Virtual banks that help to reach currently underserved individuals.

India

- 11% of the world's unbanked; 190 million people unbanked
- 90% of residents hold an Aadhaar biometric identification number

The Indian government's focus is on extending access to at least one account per household and improving financial literacy.

Technology enabler:

Investments into digital identification verification have improved onboarding through tools like eKYC.

Financial Inclusion – conclusion

Expanding access to the financial system comes with new risks that must be understood and managed.

Anti-Money Laundering, Anti-Bribery and Corruption, and Anti-Terrorist Financing:

Meeting identification and verification requirements when serving un- and underbanked customers is difficult and any gaps may expose financial institutions to regulatory and reputational risk. In addition, the reliance by un- and underbanked customers on informal channels for executing financial transactions further contributes to the concerns surrounding money laundering, corruption, and terrorist financing.

Difficulty Extending Credit:

Traditionally, financially excluded customers will have very little formal financial history (be "thin-file"), and may not have used credit products in the past. This poses a challenge for firms to determine such users' creditworthiness and could unnecessarily keep new customers from accessing credit products.

New Risks to the Customer:

When serving traditionally underserved populations, it is even more important to understand and mitigate unintended consequences as the new customers may be less financially savvy and may have less financial buffers to withstand shocks.

Structural Limitations:

The often insufficient understanding of this new type of customer and the lack of available data adds difficulty in the design and delivery of relevant products. In addition, existing distribution channels that financial services providers are used to working with may be lacking.

Technology Risk:

Companies should carefully consider their digital strategies to make sure they suit their customers' needs. In some cases, especially for older populations or less financially literate customers, there will need to be a balance between using technology and humans in delivering solutions. Solutions which make use of new technology must also be explainable to regulators from both a technical (how was this built) and purpose (why was this built) perspective. Any investments in new technology to provide financial inclusion related products come with commensurate technology risk in additional to risk already present when serving customers from vulnerable groups.

Key Takeaways

Firms will need to make their purpose explicit, **align** it with their core strategy, and ensure that plans take regulatory expectations into account. **Customer segments** should be identified and prioritised. Finally firms will need to **execute** new models that take into account the behavioural shifts that un- and underserved customers will have to make as they enter into the financial system.

Understanding and Integrating ESG – what is ESG?

Increasingly, integrating ESG activities into business-as-usual operations is not simply seen as the 'right thing to do', but also as a key factor in an organisation's business value.

ESG considerations can be defined as follows:

- **Environment** – the impact on the physical environment and resource consumption such as emissions, waste, and the use of energy or water;
- **Social** – the societal and community issues such as health and safety, labour rights, and diversity and inclusion; and
- **Governance** – the overall management procedures and systems such as stewardship, accountability and performance management.

ESG integration is how a corporate or financial firm incorporates, quantifies, and embeds these concepts into its own organisation and/or risk management processes.

ESG integrated investing is how a financial institution incorporates, quantifies, and embeds reported ESG data into its investment and capital allocation decisions.

ESG reporting is the communication of these activities through sustainability reports/metrics by corporates and, increasingly, by financial firms.

Players in the ESG ecosystem

Increasingly, financial regulators both globally and in our region have turned their attention to the 'Environment' part of the acronym.

This is particularly relevant for Asia Pacific. The International Monetary Fund notes that Asia Pacific witnessed 50% of the world's natural disasters in 2018. These disasters affected 50 million people and cost the region US$ 56.8 billion.

Understanding and Integrating ESG – climate risk, stress testing, and disclosures

ESG performance reporting has largely been applied by stock exchanges and corporate regulators to companies above a certain revenue threshold that are listed publicly. However, this is beginning to change; there has been significant and coordinated movement at the supra-national level to improve how financial institutions integrate and disclose ESG activities in their risk management processes.

Global Corporate Reporting Standards

	Global Reporting Initiative (GRI)	Sustainable Accounting Standards Board (SASB)	Integrated Reporting (IIRC)	Task Force on Climate-Related Disclosures (TCFD)
Year Founded	1997	2011	2011	2015
Approach	Specific metrics and disclosures	Specific metrics and disclosures	Principles-based	Principles-based
Important Affiliations	United Nations Environment Program	Financial Accounting Standards Board (US)	UK government	FSB
Audience	Stakeholders	Investors	Investors	Stakeholders

GRI and SASB are the two most dominant frameworks and have announced an alignment program, which will also include the TCFD.
In Europe, ESG disclosures are required to be independently audited in some jurisdictions; this is not the case in Asia Pacific.

On top of these variant global standards are the similarly variant approaches of Asia Pacific jurisdictions. Corporate ESG performance reporting regimes offer window into how reporting on ESG integration into risk management in financial firms may look in the future.

Mitigating the risks of climate change in financial services

Financial regulators tend to take the view that the integration of ESG by financial firms into risk management is an important way to improve firms' resiliency to exigent market shocks thereby helping to ensure the long-term resilience and stability of the financial markets as a whole. A key global forum for financial regulators on this topic is the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). Their stated aim is to green the financial system and strengthen the efforts of the financial sector in achieving the Paris climate agreement goals.

It is easy to see how these recommendations will ultimately flow down to the regulated community as requirements to comply with; indeed, we have begun to see the results of this work in Asia Pacific. For instance, MAS makes specific reference to working through both the NGFS and the Sustainable Insurance Forum to enhance global practices in environmental risk management and the disclosures of financial institutions. In this vein, MAS looks to issue Environmental Risk Management guidelines across banking, insurance, and asset management sectors to set standards on governance, risk management, and disclosure. A consultation paper on the guidelines is expected to be issued in early of 2020.

Understanding and Integrating ESG – conclusion

As financial regulators in Asia Pacific begin to adopt ESG reporting requirements for financial firms, it will be important for financial firms to prepare for these more stringent requirements by fully integrating ESG into both their core business model, offerings, and risk management processes.

Key Takeaways

- **Review** their current ESG policies, procedures and practices. This will also mean taking a close look at the current capabilities of talent to carry out ESG activities.
- **Ensure** commitment of the Board and top management to guarantee that ESG considerations are given attention throughout the organisation.
- **Map** reporting and disclosure obligations within and across all the jurisdictions they operate in. Close consideration should be given to the differences between any reporting currently done as a corporate and future reporting as a financial firm.
- **Understand** what kind of ESG data and metrics are currently available within the organisation, and where any gaps may exist.
- **Integrate** ESG activities fully into business as usual and risk management processes. This is an important exercise to increase resilience to non-financial risk and put firms in good stead for any reporting requirements and exercises. Good ESG integration and reporting is not a tick-box exercise.
- Where possible**, seek to influence or participate in harmonisation efforts** – currently, Asia Pacific lags behind other jurisdictions like the EU in creating a harmonised approach to ESG reporting; the specific needs of our region may not be met without the active participation of local financial supervisors and firms.

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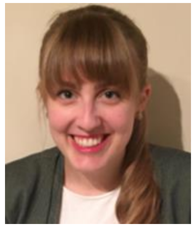

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Regulatory and Social Licences to Operate
Evolution of International Reforms
Conduct and Culture
Governance
Privacy and Data Usage
Artificial Intelligence
Financial Inclusion
Understanding and Integrating ESG
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