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ICI Global Final Responses to the Monetary Authority of Singapore's Consultation on Proposed Environmental Risk Management Guidelines for Asset Managers[1]

Q1: MAS seeks comments on the entities and business activities that are in the proposed scope of the Guidelines.

We are responding to this consultation on behalf of the members of ICI Global, which carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$31.7 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

Paragraph 1.1 proposes to apply the Guidelines to holders of a capital markets licence for fund management (LFMC) and real estate investment trust management (REIT) and registered fund management companies (RFMC), which are registered under paragraph 5(1)(i) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations (Rg. 10) (hereinafter collectively referred to as "asset managers").

We welcome the language in Paragraph 1.2, which recognizes that the scale, scope, and business models of asset managers and the investment strategies that they employ can be different and that managers will need to implement these Guidelines in a way that is commensurate with the size and nature of their activities, including the investment strategy of their funds/mandates.

We similarly support the language in Paragraph 1.2 that states that the Guidelines shall not prohibit or restrict an asset manager from complying with and discharging its fiduciary duties and other legal obligations to its customers. We have some concern, however, that the prescriptive nature of the Guidelines is not entirely consistent with this language. We urge the MAS to provide flexibility in the Guidelines so that managers can use the Guidelines as a tool for management of material environmental risk without triggering concerns about potential conflicts between the Guidelines' approach and client mandates or preferences. Given the increase in investor focus on environmental risk, we do not believe that providing additional flexibility would result in an outcome that is inconsistent with the MAS's objectives in implementing these Guidelines.

Paragraph 1.4 states that the Guidelines would not apply to asset managers that do not have discretionary authority over the investments of the funds/mandates. We support this approach and recommend clarification on whether and how the Guidelines would apply to management of passive funds/mandates given that certain elements of the Guidelines do not seem well-suited for passive

[1] Consultation available at https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Consultation-Papers/Consultation-Paper-ENRM-Guidelines-AM.pdf.

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investment strategies. We strongly recommend that the Guidelines permit managers to apply them in ways that are appropriate for different types of strategies.

Paragraph 1.5 states that asset managers that delegate investment management to sub-managers or sub-advisers still retain overall responsibility for environmental risk management. We ask the MAS for clarification on how the Guidelines would apply to sub-managers or sub-advisers. Where a Singapore licensed or registered manager acts only in the capacity of a sub-adviser (whether they are a delegate exercising discretion over the entire portfolio or just a sleeve), they are contractually bound to follow parameters set by the primary manager. If the primary manager is located in another jurisdiction and subject to requirements covering matters that are similar to those of the Guidelines (e.g., if the primary manager is subject to EU regulation, which imposes extensive requirements related to environmental risk management), there may be potential conflict or unnecessary duplication for the sub-adviser.

Paragraph 2.3 defines environmental risks as (1) physical and transition risks to an investee company's business activities that pose a financial risk to an investor's returns, and (2) reputational risk to an asset manager, where investments in companies that have a negative environmental impact may create negative perception of asset managers' business practices and adversely affect their abilities to maintain or grow their assets under management. We are concerned that this reference to reputational risk to asset managers appears inconsistent with the Guidelines' focus on investment risks that have a potential financial impact on investors' returns (i.e., physical and transition environmental risks). Reputational risk to an asset manager's overall business is a business risk, not an investment risk, and it does not present a potential financial impact to funds/mandates managed by asset managers on behalf of fund investors/clients.

Q2: **MAS seeks comment on the proposed responsibilities of the Board in overseeing environmental risk management, which include approving an environmental risk management framework and policies, and setting clear roles and responsibilities of the Board and senior management.**[2]

As the MAS develops its Guidelines, it is essential to differentiate between risk to the value of a particular investment (e.g., physical and transition risk) and risk to an asset manager as an organisational entity (e.g, reputational risk). Throughout the rest of our consultation response, we refer to these two categories of risk as "investment risk" and "business risk."

We recognize the importance of the Board in ensuring that a manager has in place a robust risk management and governance framework. We are concerned, however, that the Guidelines' requirements, among others, appears to intermingle business risk management with investment risk management. The Board is best placed to oversee business risk to the firm, while investment risks at the portfolio level are best managed by the portfolio managers themselves.

[2] *See* Consultation Question 2, on p. 7 and 19-20.

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An asset manager's Board, for example, should not be responsible for managing material risks to an investment portfolio. Elevating environmental risk for review at the Board level (unlike other specific investment risks that may, in fact, be more critical to the performance of an investment firm's particular strategies) and suggesting that a particular individual be responsible for this specific risk gives the mistaken impression that environmental risk trumps other material investment risks, as discussed further in our response to Question 4.

We therefore ask the MAS to better clarify and distinguish between investment risk management and business risk management in its Guidelines.

Q3: MAS seeks comment on the proposed responsibilities of senior management, which include developing an environmental risk management framework and policies, regularly reviewing their effectiveness, and allocating adequate resources to manage environmental risk of the assets managed.[3]

Although we agree that senior management responsibilities should include oversight of a rigorous risk framework for the investment process, we have concerns that the Guidelines around this requirement, similar to the Board oversight requirement, appear to confuse business risk management with investment risk management.

We note that senior management responsibilities generally are not intended to address specific investment risks to the value of individual portfolio securities. Rather, senior management responsibilities are intended to address business risks such as valuation or the risk that a fund's approved investment strategy is not being appropriately followed. The Guidelines should not specify senior management's responsibility for security-level investment risks because integration of these material investment risks is a core responsibility of the investment team.

As an overarching comment, an asset manager should be permitted to establish its governance framework in a manner that reflects the size, nature, and complexity of its business. For example, global financial institutions with multiple business divisions (e.g., banking and asset management) should have the flexibility to establish cross divisional or geographical governance frameworks (e.g., board/committee). In this scenario, an asset manager may have a divisional committee for overseeing environmental risk management, while there also may be a Board/committee at the group level to establish the framework and policies for the group as a whole.

[3] *See* Consultation Question 3, on p. 7 and 19-20.

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Q4: **MAS requests comment on its proposal that, where environmental risk is deemed material to the funds/mandates managed, asset managers should designate a senior management member or a committee to oversee environmental risk.**[4]

We do not see merit in requiring (expressly or otherwise) the designation of a single person or committee to be responsible for oversight of material environmental risk to investments.

Mandating a person within the firm to be responsible for oversight of material environmental risk to investments could lead to a compliance-heavy, box-ticking approach, which would undermine the focus on integrating material ESG information in the investment process. ESG integration is part of the investment process. The portfolio management team is best positioned to analyze the ESG factors affecting a particular investment and incorporate that analysis into investment selection, allocation, and stewardship. Requiring the designation of a single person across an entire organisation would only encourage the separation of environmental risk analysis from the investment process, which would be contrary to the purpose of ESG integration.

Having a specific designee responsible for environmental risk integration also would jeopardize skewing the overall risk assessment of an investment. The fact that a particular risk is conventionally classified as an environmental risk will not be conclusive as to whether it is financially material or not. We note that Question 4 seems to assume that a particular environmental risk would be material for all investments, and we further discuss the importance of materiality in our response to Question 5.

Environmental risk may be only one material risk that the portfolio management team takes into account in the investment process, and designating a responsible designee only for this risk would unnecessarily elevate this risk above all else.

If the MAS moves forward with requiring a specific designee to oversee environmental risk, it will be essential for asset managers to have flexibility on where to locate that individual or committee.

Q5: MAS seeks feedback on the examples of tools and metrics that may be used by asset managers to assess the impact of environmental risk at both the individual investment and portfolio level.[5]

Paragraph 4.1 states that asset managers should embed relevant environmental risk considerations in their research and portfolio construction processes if they have assessed them to be material. We welcome the emphasis on materiality. Portfolio managers do not (and should not) treat all risks equally or treat them as being meaningful in all circumstances. In determining whether environmental risk is material to a particular investment, a portfolio manager analyzes the relevance of the information to the industry in which it operates and the potential impact on the financial health of the investment in the context of a fund's investment strategy. Similar analysis is often applied at a sector and mandate level.

[4] *See* Consultation Question 4, on p. 8 and 19.
[5] *See* Consultation Question 5, on p. 8 and 21-23.

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The fact that a particular risk is conventionally classified as an environmental risk will not be conclusive as to whether it is financially material or not to a specific investment, and/or to one sector or strategy and not another. A particular environmental risk may be material to one portfolio investment but not material to another depending on various factors.

Paragraph 4.3 states that, for sectors with higher environmental risk, asset managers should develop sector-specific guidance internally to aid its investment personnel in understanding the environmental issues pertinent to such sectors. We question the utility of prescribing sector-specific guidance that does not take into account materiality. An asset manager should have flexibility to develop guidance for its investment personnel depending on strategy and investment objectives.

We generally caution against a prescriptive approach to the use of tools and metrics for management of environmental risk to investments. Fund managers consider material environmental risks in the investment process as they do other material investment risks, such as interest rate risk or credit risk. Because of the unique nature of each fund manager's individualized and proprietary investment process, there is no uniform way to integrate material environmental risks into the investment process.

In fact, developing uniform criteria for environmental risk assessments would turn these assessments into a check-the-box exercise that is less meaningful than the more in-depth, tailored risk analysis that many asset managers currently are performing. Asset managers should, instead, be provided the flexibility to adapt their environmental risk analyses in a manner that is appropriate for their particular investment process.

We believe that continued market development of this practice, driven by burgeoning client demand and market competition, is most likely to lead to efficient, well thought-out approaches. For this reason, it is critical that any regulation of or requirement for integration of environmental risk be principles-based, provide flexibility, and not negatively impact the investment process. An inflexible, prescriptive approach could disrupt evolution of good investment practices, turning environmental risk integration into an artificial compliance checklist, or impose a separate overlay onto the investment process that would defeat the purpose of the MAS's objective of fostering true integration of environmental risk.

Paragraph 4.6 states that asset managers' approach to managing environmental risk could be influenced by the investment objective and strategy (active vs. passive) of the fund/mandate that they manage. This paragraph focuses solely on management of environmental risk in active and passive strategies. We note, however, that the need for flexibility and a principles-based approach applies far more broadly than simply to the differences between active and passive. For example, a fund manager may integrate environmental risk information differently for a fixed income investment strategy as compared to an emerging markets equity strategy (or even between two emerging markets equity investment strategies, depending on clients' preferences as reflected in each fund's guidelines), and the MAS's approach must allow for these differences. Moreover, a manager may vary its approach to managing

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environmental risk for a sustainability-focused fund as compared to a fund that does not have that same focus.

We also note that it is essential that global managers have the flexibility to implement global processes, where relevant, to be able to satisfy the MAS's requirements. Integration of material environmental risk should not be a separate process, but rather part of a manager's existing paradigm used to manage investment risks more broadly.

Q6: MAS seeks feedback on the examples of tools and metrics that may be used by asset managers to conduct ongoing portfolio risk management, including scenario analysis.[6]

We are deeply concerned about the prescriptive nature of the proposed Guidelines with respect to scenario analysis. We believe the current state of scenario analysis is unlikely to provide useful information to investors and may even be misleading to investors that place undue reliance on its outcome.

Service providers use a variety of methodologies in estimating the level of climate risk associated with specific climate change pathways. Most of these analyses seek to provide insights on the purported exposure to physical risks, transitional risks, and opportunities associated with climate change. In general, the methodologies behind these analyses are highly sensitive to inputs that are subjective and can, in fact, vary extensively. Therefore, the range of potential outcomes of the analyses will also vary widely, depending on the methodology used and the assumptions made.

For instance, transitional risk is dependent on many inputs, including the probability, timing, magnitude, and scope of governmental regulation. It is impossible to gauge many of these inputs with any precision (e.g., estimates of a carbon tax that have over a 5x range from low to high). Scenario analysis for specific 1.5 or 2.0 degree (or other) pathways also assumes some probability of governmental response (e.g., imposing a carbon tax); this is often based on a subjective view of risk. The methodologies also may not account for timing of potential government action. In addition, some providers choose not to provide details on the proprietary methodology used to calculate their results. Further, most of these methodologies do not account for differences both between and within sectors in how climate risks may impact profitability/long-term viability based on differences in industry structure, geographic mix, and other factors. Although service providers are focused on developing scalability of scenario analysis methodologies, we note that scale cannot come at the expense of security-level accuracy.

In sum, scenario analysis is still nascent, and mandating that asset managers use scenario analysis in a particular way would be counterproductive at this juncture. We instead recommend including a high-level reference in the Guidelines stating that asset managers should incorporate scenario analysis where appropriate. This would allow flexibility for assessing physical risks and scenario analysis, recognizing the

[6] *See* Consultation Question 6, on p. 23-24.

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developing nature of this discipline and that the data available on the market remains incomplete as well as a lack of adequate disclosure from investee companies.

In addition to our overarching comments on scenario analysis, we also caution that the requirements seem to conflate business risk management with managing investment risks. Section 5.4 in particular seems aimed at managing investment risk, while the other provisions seem linked to business risk management.

We separately urge the MAS to include language that emphasizes the importance of materiality in this context and that scenario analysis is intended to help the manager focus on material risks.

We also are concerned that it is unclear how the principle of proportionality would apply for firms in complying with these scenario analysis requirements. Asset managers must have flexibility to manage environmental risk in the investment process, in a manner that is proportional to their size, organisational structure, and other elements.

Q7: MAS seeks comments on the expectation for asset managers to incorporate environmental risk considerations into their stewardship frameworks, including establishing a process for issue prioritization and maintaining proper documentation.[7]

Asset managers often take material ESG factors into account in their engagement activities under their particular circumstances, and we generally support the proposed Guidelines' principles-based expectations with respect to stewardship. Asset managers engage with companies held in a variety of mandates to encourage them to adopt robust business practices consistent with sustainable long-term performance. The language in Paragraph 6.1 discusses prioritising issues and companies for engagement in a way that is consistent with client interests and aligned with the asset manager's investment objective and strategy. We welcome this language and further urge the MAS to link engagement expectations to materiality. The fact that a particular risk is classified as an environmental risk will not be conclusive as to whether it is financially material or not to a specific investment. Depending on a variety of factors, a particular environmental risk may be material to one portfolio investment but not to another, and managers' stewardship activities cover a wide range of important matters beyond environmental risk.

Although asset managers engage with investee companies on a broad range and variety of issues, Paragraph 6.2 lists only environment-related examples. We recommend framing this list with introductory language as follows: "In the context of environmental risks, topics for engagement with investee companies may include but are not limited to . . . ."

We have concerns with the language in Paragraph 6.3 around collaborative engagement, as this could potentially conflict with strict antitrust requirements in other jurisdictions, particularly in the US. The

[7] *See* Consultation Question 7, on p. 25-26.

Guidelines around engagement with investee companies should not conflict with antitrust requirements in other jurisdictions, as many asset managers employ group-level engagement policies. We recommend replacing Paragraph 6.3 with the following language: "Asset managers may consider collaborative engagements with other investors, to the extent consistent with applicable law." This language would provide asset managers with more flexibility to collaborate on issues such as developing and supporting the development of reporting frameworks, while complying with all applicable antitrust laws.

Q8: MAS seeks comments on the proposed form of disclosure of environmental risk by an asset manager.[8]

Paragraph 7.1 states that asset managers should disclose their approach to managing environmental risk in a manner that is clear and meaningful to their stakeholders, including existing and potential customers. We urge the MAS to revise this sentence as follows: "Asset managers should disclose their approach to managing environmental risk in a manner that is clear and meaningful." We believe that the MAS intended this disclosure to assist investors in understanding how the manager is managing material environmental risks to client assets.

We disagree with the requirement to consolidate an asset manager's disclosure at the group or head office level. We recommend against mandating this disclosure given that group or head office level disclosure is not likely to be meaningful to a fund investor or client invested in a segregated mandate. Similarly, aggregate disclosure of quantitative metrics does not provide any useful information to end investors about the materiality of a particular investment risk to a particular security. We urge the MAS to reconsider this disclosure requirement so that it is useful for end investors. Institutional clients already request and receive extensive and tailored reporting, while retail end investors may be best served with qualitative disclosure about how the manager addresses material sustainability risk to their investments.

Paragraph 7.2 states that asset managers should take reference from international reporting frameworks, including the TCFD recommendations, to guide their environmental risk disclosure. Rather than codifying a particular reporting framework such as the TCFD, we recommend clarifying that this is an example of one international framework that managers could use.

Q9: MAS seeks comments on any aspects of the Guidelines that have not been covered in earlier questions.

Paragraph 2.5 notes that asset managers can play a key role in the transition towards an environmentally sustainable economy by channeling capital through their green investment activities. We are concerned that this statement is not consistent with the purpose of the Guidelines, which involves identifying and mitigating material risks to protect client assets.

[8] *See* Consultation Question 8, on p. 10 and 26-27.

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With respect to asset managers' channeling of capital, we emphasize that asset managers are not asset owners but fiduciaries acting on behalf of investors. Client assets are entrusted to the asset manager subject to fiduciary duties and contractual constraints. We therefore strongly support the statement in Paragraph 1.2 clarifying that the Guidelines shall not prohibit or restrict an asset manager from complying with and discharging its fiduciary duties and other legal obligations to its customers. This statement appropriately recognizes that asset management is based on an agency relationship: asset owners hire asset managers to invest assets on their behalf.

Asset managers act as fiduciaries, which means acting in the best interests of the client and faithfully executing the investment mandate provided by the client. Asset managers invest within the guidelines specified by their clients for a given mandate as set out in the investment management agreement. For regulated funds, a fund's manager invests in accordance with investment objectives and policies that are established by the fund's offering or constituent documents. In both contexts, the client or fund investor assumes the risk of investing rather than the asset manager. It is therefore essential that asset managers make investment decisions in the interest of their clients/investors only and invest in a manner that they assess will best achieve a client's mandate or a fund's stated investment objectives.

Q11: MAS seeks comment on its proposed implementation approach, including a 12-month transition period, beginning once the Guidelines are finalized, for financial institutions to implement the Guidelines.[9]

We strongly recommend that the MAS provide asset managers with a 24-month implementation timeline to ensure a meaningful implementation of the Guidelines. Global managers typically address ESG-related implementation projects on a global basis, and asset managers are currently dealing with an unprecedented implementation schedule of new ESG-related regulatory requirements in other jurisdictions, such as the HKMA environmental risk framework and a host of extensive new obligations on EU financial market participants and financial products. We also urge the MAS to ensure that the requirements under the Guidelines do not conflict with those introduced in other jurisdictions, in particular in Hong Kong and the EU. This is particularly important for firms with global footprints that will need to comply with multiple requirements.

[9] *See* Consultation Question 11, on p. 11.