

EFFECTIVE DEVELOPMENT & IMPLEMENTATION OF ESRM GUIDELINES



Mike Coates, Director, GBRW Limited

Bangkok | 1 December 2022

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Introduction

Effective Development and Implementation of ESRM Guidelines

- Focus of presentation solely on credit institutions – though there are similarities with other financial sub-sectors
- There is not currently a global standard for alignment – but there are parallel initiatives (NGFS, BIS)
- Jurisdictions in Asia and the Pacific are at different points in implementation
- Also, financial systems in Asia and the Pacific highly heterogeneous and the approach needs to be tailored
- Early adopters usually had specific local E&S issues they wanted to address- climate was not necessarily a major driver in the first instance
- Understand that there is sometimes tension in the mandates of central banks – balancing financial stability with financial inclusion with E&S risk management
- ESRM Guidelines only part of Sustainable Finance ecosystem - necessary but not sufficient

Balancing ESRM with Wider Central Bank Mandates

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Financial Stability

- Encourage banks to understand E&S risks (particularly climate) to their portfolios
- Operational risk is also a key discipline of ESRM and could be considered part of SREPs
- Effective ESRM should cascade through into reduced PDs
- Central banks themselves need to be able to aggregate ESRM data and identify systemic risks
- Facilitating flows of adaptation finance critical in reducing systemic risks

Financial Inclusion

- Financial inclusion is a key pillar of financial stability
- Financial inclusion is a key assumption underpinning sustainable development
- Access to transition finance to support decarbonization vital to achieving NDCs
- Access to adaptation finance to protect lives and livelihoods also a fundamental aspect of sustainable finance
- The financially-excluded (e.g., women, ethnic minorities, displaced people, rural populations) at greater risk of exposure to climate-related extreme weather events

Challenges and Opportunities of ESRM for Credit Institutions

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Challenges

- Many banks seem to be legitimately concerned about costs of implementation (and particularly by quotes from their consultants)
- Concern about challenges in compliance by SMEs will inhibit access to finance
- Concern about level-playing field and danger of race-to-the-bottom by borrowers
- Danger that ESRM will be relegated to a due diligence adjunct to the credit process (see parallels with ALM/CFT)
- Lack of internal capacity and expertise in ESRM

Opportunities

- Offering customers enhanced non-financial services in ESG risk management
- Consider establishing an ESG data consortium
- Lower cost of operational risk capital requirements
- Lower cost of wholesale finance and improved valuation
- Strategic differentiation through re-segmentation of market and reformed credit process focused on sustainable segments

Critical Success Factors

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Regulators

- Understand your market! And the differences between them
- Sensitise your franchise through consultation and exposure drafts for discussion
- Balancing Level of detail (prescriptive vs principles based)
- Managing compliance – mandatory versus voluntary versus explanatory standards

Credit Institutions

- Ensure that ESRM is strategic, built into the risk appetite statement and cascading through corporate strategy and EWRM
- Build ESRM into the risk management culture
- Ensure that ESRM is built into risk MIS and risk reporting framework to board level
- Ensure ESRM KPIs built into strategic and performance management framework and cascade through organisation

Conclusions and Observations

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- ESRM is MUCH more than a due diligence requirement in the lending process – or at least it has to evolve that way
- In order to evolve, however, it needs to be aligned with much broader international and national initiatives – this is why it so often features as part of a holistic sustainable finance roadmap
- Sustainability-linked loans (e.g., transition finance) are an example where some very joined up thinking is required
- In this case ESRM should be strategic to credit institutions – and work hand in glove with financing sustainability
- Needs to be integrated into all steps of the credit risk management process (not just a due diligence box-ticking exercise). Don't forget about operational risk!
- More capacity building support required for smaller and mid-sized credit institutions AND central banks – particularly in climate risk management

Ultimately, we need to find a solution where a credit institution receives a relative improvement in the cost of capital for adopting better ESRM practice than competitors. What role regulatory incentives (sanctions)...?

Annex: Programme

Effective Development and Implementation of ESRM Guidelines

Session 5. The role of central banks in supporting the growth of sustainable finance

Hybrid format, Bangkok and on-line

Globally and within the Asia-Pacific region, Central Banks are increasingly focused on establishing clear green financing guidelines and strategies. Climate change can have a significant impact on economic and financial system stability. This session focuses on the role of central banks in ensuring financial stability in a changing climate. The session also looks at measures and best practices that central banks are adopting on green and sustainable finance in the region.

Moderator:

Ms. Suba Sivakumaran, Chief, Finance for Development Section, MPFD, ESCAP

Presentation:

Mr. Michael Coates, Managing Director of GBRW Companies/Expert on FFD Report, MPFD

Experts:

- **Mrs. TMJYP Fernando**, Deputy Governor, Central Bank of Sri Lanka
- **Mr. Youraden Seng**, Director, Banking Supervision Department II, National Bank of Cambodia
- **Ms. Lyn Javier**, Assistant Governor of the Policy and Specialized Supervision Sub-Sector, Bangko Sentral ng Pilipinas, Philippines
- **Mr. Chowdhury Liakat Ali**, Additional Director, Sustainable Finance Department, Bangladesh Bank (pending final confirmation)

Annex: Questions

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- How do we ensure that ESRM guidelines encourage credit institutions to lend more to MSMEs with sustainable business and operating models? How do we avoid putting more barriers in access to finance for MSMEs?
- Should ESRM guidelines be compliance- or risk-based, and what are the pros and cons of different approaches?
- How have ESRM guidelines evolved? Are there benefits in different models of adoption - voluntary versus mandatory versus explanatory? How did the public and private sector collaborate in the development of the guidelines, if at all?
- What is the best way to roll-out guidelines? What support in terms of sensitisation, training, and capacity building was required?
- How were the guidelines received by the industry? Was there any resistance to adoption and how did you handle this?
- What can be done with the ESRM data we are collecting from credit institutions, and how can we use it to benefit the sector as a whole?
- Do you have any plans for financial or non-financial incentives for credit institutions that adopt exemplary values and behaviours vis-a-vis ESRM?
- What should the international community be doing to support or assist with ESRM development and adoption?