Policy Statement of the Bank of Thailand
Re: Internalizing Environmental and Climate Change Aspects into Financial Institution Business

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BANK OF THAILAND

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Financial Institutions Strategy Department

Financial Institutions Policy Group

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Unofficial Translation
This translation is for the convenience of those unfamiliar with the Thai language.
Please refer to the Thai text for the official version

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1. Rationale

Environmental issues, particularly climate change, have continuously intensified. This has led various countries to start transitioning towards low carbon economy under the Paris Agreement and the commitment at the United Nations Climate Change Conference of the Parties (COP). Thailand has pledged to achieve carbon neutrality by 2050 and net zero emissions by 2065. In addition, financial regulators agree that climate change may create direct and indirect impacts upon households, businesses, financial institutions, and the overall stability of the economic and financial systems, especially during the transition period towards environmental sustainability.

Thailand has been ranked as one of most impacted countries by extreme weather events[1], furthermore, the business sector has an increasing tendency to abide by environmental policies and regulations in accordance with international standards. Therefore, the Bank of Thailand (BOT) has issued this policy statement so that financial institutions and companies within the financial business group can appropriately assess climate-related opportunities and risks as part of their business conduct without creating additional risks. Also, they should be able to provide green financial products and services to support concrete transition for the Thai economic and financial system.

2. Scope of Application

The BOT requests financial institutions and companies within the financial business group[2] to apply this policy statement in accordance with their organizational structure, size, business complexity, and materiality of environmental risks on their businesses (risk proportionality principle) to achieve tangible results.

In cases where other financial regulators, such as the Securities and Exchange Commission or Office of Insurance Commission, have issued regulations or guidelines relating to internalizing environmental and climate change into the financial

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[1] Global Climate Risk Index 2021, Germanwatch

[2] Parent company of a financial business group should regulate and monitor its financial subsidiaries to ensure that their business operations are in line with the group's overall environmental and climate-related policies and strategy.

business specifically for their regulated sectors, companies within the financial business group under such regulators should abide by their regulators' regulations or guidelines.

3. Content

3.1 Definitions

"Environmental risks" is defined as the probability of loss to business from the issues of environmental and climate change, which includes business conduct of clients or counterparties that create negative externalities such as greenhouse gas emissions, deforestation and destroying biodiversity, polluting (air, land, and ocean), creating toxic material and waste. All of which could have both direct and indirect impacts upon the financial institution's and its stakeholder's financial status and reputation (details as per the appendix). This can be divided into "physical risk" and "transition risk".

"Physical risks" is defined as the probability of losses to assets and business operations due to acute natural disasters[3] and chronic environmental changes that can occur slowly overtime[4]. Examples include natural disasters which could adversely impact the real estate and tourism sectors, droughts which could impact the agricultural sector productivity, and increased sea levels which could impact the communities and businesses along the coast.

"Transition risks" is defined as the probability of losses to assets value, competitiveness, and relevant business operations from changes in various factors including consumers' and investors' preferences, official regulations and policies, and technology developments to address environmental issues and transition towards a low carbon economy. Examples include the reduction of plastic usage, government policy to reduce fossil fuel usage, clean technology regulation, or the collection of carbon tax.

"Board of Directors" is defined as Board of Directors of the financial institution. This also refers to the management committee with similar responsibility and authority in case of foreign commercial bank branch.

"Senior management" is defined as senior executives in accordance with the definition in the Notification of the Bank of Thailand RE: Corporate Governance of Financial Institutions and Financial Business Groups.

3.2 Principles

The BOT expects financial institutions and companies within the financial business group to adopt this policy statement to systematically assess the

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[3] Such as forest fires, flood, or storms which are considered as acute physical risks.

[4] Such as changes in temperature, sea level, or rainfall which are considered as chronic physical risks.

environmental impact both in terms of opportunities and risks in the decision-making process and operations which, in turn, support the economic transition and elevate their business operations to align with international sustainability standards[5]. The policy statement can be applied to 4 aspects as follows:

1. Governance: Encompasses the responsibilities of the Board of Directors in providing strategic direction and key policies and overseeing the environmental actions. This also covers the key responsibilities of the senior management in ensuring the strategic direction and policies, which have been put into practices throughout the organization, including managing opportunities and risks, as well as establishing adequate internal responsibilities and resources to support environmental actions.

2. Strategy: Encompasses the consideration of opportunities and risks from environmental changes that impact the financial institutions and its stakeholders and the integration of such factors as parts of the process in setting strategies, goals, as well as implementation plans that lead to the transformation of work processes and financial products and services to support client's transition in a tangible manner.

3. Risk management: Encompasses the integration of environmental risks as part of the organizational risk culture and risk management process with regards to the Three Lines of Defense model, as well as having in place policies, mechanisms, and data capability to support effective risk management. Lastly, there should be policies and processes to identify, assess, control, monitor and report environmental risks.

4. Disclosure: Encompasses the disclosure of information on governance, strategies, implementation plans, environmental opportunities and risks management, as well as environmental metrics and targets that reflect current status and are in line with international standards. These are reflected as follows:

3.2.1 Governance

The Board of Directors and senior management should play an important role in setting the "Tone from the top". The Board of Directors should provide strategic direction and key policies and overseeing the environmental actions, while the senior management should ensure the strategic direction and policies have been put into practices throughout the organization which includes

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[5] Examples of international sustainability standards including Principles for Responsible Banking (UNPRB), Principles for Responsible Investment (UNPRI), Equator Principles, and the recommendations from Task Force on Climate-Related Financial Disclosures (TCFD), and Principles for the effective management and supervision of climate-related financial risks from Basel Committee on Banking Supervision.

managing opportunities and risks, as well as establishing adequate internal responsibilities and resources to support environmental actions.

(1) The Board of Directors should:

(1.1) set strategic directions, risk appetite, key policies, and overall framework considering opportunities and risks which could occur from environmental changes both in the short and long term. Furthermore, the Board of Directors should oversee the progress and outcome in this regard by ensuring regular reporting from management in order to review and adjust strategies to the new opportunities and risks that can suddenly emerge in a timely manner.

(1.2) ensure financial institution's governance structure, roles, and responsibilities in promoting environmental actions for tangible outcome. There should be a clear responsible authority to manage the environmental opportunities and risks within the stipulated framework and integrate these environmental issues into normal business operations. This includes, for example, strategy development, risk management, credit underwriting process, investment analysis, disclosure, and internal audit.

(1.3) place importance on adequate resource allocation to support environmental actions to achieve the target.

(2) The senior management should:

(2.1) put in place responsibility structure and allocate internal resources to adequately support the environmental actions.

(2.2) set environmental implementation plan that includes the management of opportunities and risks. The senior management should also communicate the direction, policies, and implementation plans related to environmental actions so that relevant departments are informed and can implement them tangibly.

(2.3) consistently monitor progress and achievement of the implementation plan and regularly report to the Board of Directors.

(2.4) ensure knowledge and capacity building for relevant staff across all levels, particularly in terms of environmental risk management, to be ready for changes and support the organization's environmental actions.

3.2.2 Strategy

Financial institutions should consider opportunities and risks from environmental changes that impact the financial institutions and its

stakeholders and integrate these factors as parts of the process in setting strategies, goals, as well as implementation plans that lead to the transformation of their work processes and financial products and services to support client's transition in a tangible manner. Financial institutions should:

(1) integrate environmental factors as part of the process in setting and reviewing strategic plans, risk appetite, and both short and long-term implementation plans in accordance with the materiality that may directly and indirectly impact the financial institutions. Furthermore, financial institutions should have in place materiality assessment processes with relevant stakeholders to regularly review various strategies.

(2) put in place an evaluation process to measure the success of implementation plans within the organization's risk appetite framework, including setting clear target and key performance indicators for effective assessment and monitoring, such as setting the target on environmentally friendly funding within the specified timeframe or science-based emission reduction targets[6].

(3) support the economic transition towards environmental sustainability by providing advice to raise awareness and financial products and services that create incentives for clients or counterparties to change their business practices to be more environmentally friendly. This includes green bonds, sustainability bonds, green loans, and sustainability-linked loans that support appropriate business transition. These products and services should be in line with accepted Green Taxonomies, such as the ASEAN Taxonomy for Sustainable Finance or Thailand Taxonomy. Furthermore, the involvement of experts in the issuance and verification processes is recommended to prevent potential Greenwashing[7].

3.2.3 Risk management

(1) Financial institutions should integrate environmental risks as part of the organizational risk culture and risk management process with regards to the Three Lines of Defense model, as well as having in place policies, mechanisms, and data capability to support effective risk management. Lastly, there should be policies and processes to identify, assess, control, monitor and report environmental risks. Financial institutions should:

(1.1) integrate environmental risks as part of the risk culture, attitude, and behavior of staff across all levels within the organization, which covering

[6] Such as greenhouse gas emission reduction targets in line with the Paris Agreement based on climate science, which targets the average global temperature increase of no more than 1.5 – 2.0 degree Celsius.

[7] Greenwashing is the manipulation of public disclosure to create a false sense of environmental responsibility.

risk awareness, risk taking, and risk management in normal business operations, in accordance with the Bank of Thailand's Policy Statement on Financial Institutions' Risk Culture.

(1.2) establish clear structure and scope of responsibility to support environmental risk management which cover:

(1.2.1) Business units or the first line of defense should preliminarily evaluate and control environmental risk to ensure that business decisions are appropriately accounted for environmental risks. This includes, for example, enquiry about environmental actions and impacts as part of the processes for accepting new clients and reviewing existing clients' risks profiles, especially in the case of high-risk industries.

(1.2.2) Second line of defense such as risk management, compliance, and credit review units should integrate environmental risks as part of the organization's overall risk assessment and establish risk assessment frameworks that can balance the decision-making power. This includes for example, the right to object to the first line's decision, and ensure that the environmental risk assessment process is aligned with the risk appetite, other relevant regulations, and laws.

(1.2.3) Internal audit units or third line of defense should be independent in their audit of the risk management framework, internal control, and related monitoring. This is to ensure that the overall organizational conduct supports environmental risk management effectively in an end-to-end manner.

(1.3) establish policies and processes for systematic environmental risk management both at the transaction and portfolio levels (details in 3.2.3 (2) (3) and (4)). This also includes communicating to relevant staffs to raise awareness and understand the guidelines. Furthermore, there should be an appropriate and consistent review of the policies and processes in line with the materiality of environmental risk.

(1.4) assess the potential environmental impact on the business operations and risk exposures including credit, market, liquidity, operational, and other risks such as strategic and reputational risks. Furthermore, there should be appropriate risk management systems and adequate capital regarding the materiality of each of risk dimensions (details as per the appendix).

(1.5) compile, store, and report necessary information for the assessment and management of environmental opportunities and risks, such as clients and counterparties' environmental performances, as well as ensure the quality of

information to be in line with the recognized environmental standards so that such information can be utilized in risk analysis and management effectively.

(2) Financial institutions should have in place an up-to-date policies and processes in identifying and assessing environmental risk both at the transaction and portfolio levels. Financial institutions should:

(2.1) establish policies and processes in identifying and assessing environmental risk to support the decision-making process. This includes, for example, inquiring environmental information from clients during loan and investment analysis so that they can appropriately evaluate clients' and counterparties' environmental risk levels and risk management capacity. High materiality risk transactions should be evaluated by environmental experts with no conflict of interests in such transactions.

(2.2) develop tools and processes in identifying and assessing environmental risks such as setting up portfolio heatmaps and risk indicator indexes to categorize clients or counterparties in accordance with their level of environmental risks to ease overall risks monitoring. Financial institutions may reference guidelines from environmental certification or international environmental standards such as the International Finance Corporation (IFC) Performance Standards. Furthermore, financial institutions should establish additional practices for loan, investment, and other contractual obligations in high-risk industries or business sectors (e.g. requiring approval by higher-level management).

(2.3) assess and review environmental risks and impact that may result in financial risks regularly, using forward-looking method, both quantitatively and qualitatively. This includes, for example, considering environmental factors when conducting scenario analysis and stress testing and use the results as part of developing business strategy, risk management, internal capital adequacy assessment process[8], and financial performance reporting. In this regard, financial institutions should decide the frequency of risk assessment and review in line with clients' and counterparties' risk materiality, sectors, type of transactions or portfolios.

(3) Financial institutions should have in place policies and processes to control and mitigate environmental risks to acceptable level both at transaction and portfolio levels. Financial institutions should:

(3.1) establish policies and processes to reduce or avoid transactions that create severe negative environmental impact, in line with various

[8] In case of significant impact or risk materiality, financial institutions should follow the Bank of Thailand's notification on Supervisory Guideline on Capital under Pillar 2.

standards, regulations, and laws. This includes, for example, establishing an industry exclusion list which is continuously reviewed to align with changing situations, as well as enforcing relevant departments to strictly follow the policies and processes.

(3.2) establish additional risk mitigation measures for high-risk client or counterparty groups. This includes, for example, setting financial product covenants to raise the quality of clients' or counterparties' environmental operations to be in line with set indicators or environmental standards within a specified timeframe, or the integration of environmental risk as part of interest rates setting or collateral evaluation processes.

(3.3) develop risk indicator targets to control risk levels in line with the risk appetite. This includes, for example, setting the industry targets to increase the proportion of environmentally friendly transactions, or setting targets to reduce or control the concentration of industries that pose environmental risks.

In this regard, financial institutions' environmental risk control and mitigation as mentioned above should also consider and support clients' or counterparties' phase out of environmentally unfriendly activities.

(4) Financial institutions should have in place policies and processes to monitor environmental risks both at the transaction and portfolio levels and be able to consistently report to the Board of Directors and senior management in a timely manner. Financial institutions should:

(4.1) establish policies and processes in monitoring and reporting environmental risks to the Board of Directors and senior management in a consistent manner to support the review of strategies, risk appetite, risk management, and evaluation of the overall implementation plan. In this regard, the methodology and frequency for monitoring and reporting should be in line with the risk materiality and its significance to financial institutions' business position.

(4.2) develop tools and processes to consistently monitor risks, progress, and results of clients' or counterparties' environmental implementation plan, particularly those that have high risk, in accordance with the established policies or criteria (e.g. setting conditions for clients or counterparties to report environmental risk data, including the progress in reducing such risks on a regular basis). In addition, financial institutions may utilize sustainability data service providers to monitor such data.

3.2.4 Disclosure

Financial institutions should publicly disclose climate-related information on governance, strategies, implementation plans, opportunities and risks

management, as well as metrics and targets that reflect current business operations and are in line with international standards. Financial institutions should:

(1) disclose climate-related information that is in line with internationally accepted regulations or standards such as the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)[9] or the guidelines from the International Sustainability Standards Board (ISSB). The disclosure should cover the following information.

(1.1) Governance structure and the roles of the Board of Directors and senior management with regards to overseeing environmental actions.

(1.2) Strategy and implementation plan including desired results and achievement of the environmental actions in qualitative and quantitative terms.

(1.3) Environmental opportunity and risk management including operation and framework for risk management.

(1.4) Metrics and targets which cover important environmental data for evaluation and illustration of the financial institutions' environmental actions against its target (e.g. their own greenhouse gases emissions and financed emissions in their portfolio).

(2) consistently disclose the above information at least once a year via various communication channels such as annual report, sustainability report, or website. Furthermore, financial institutions should ensure that information are consistently updated in line with the financial institutions' current policies.

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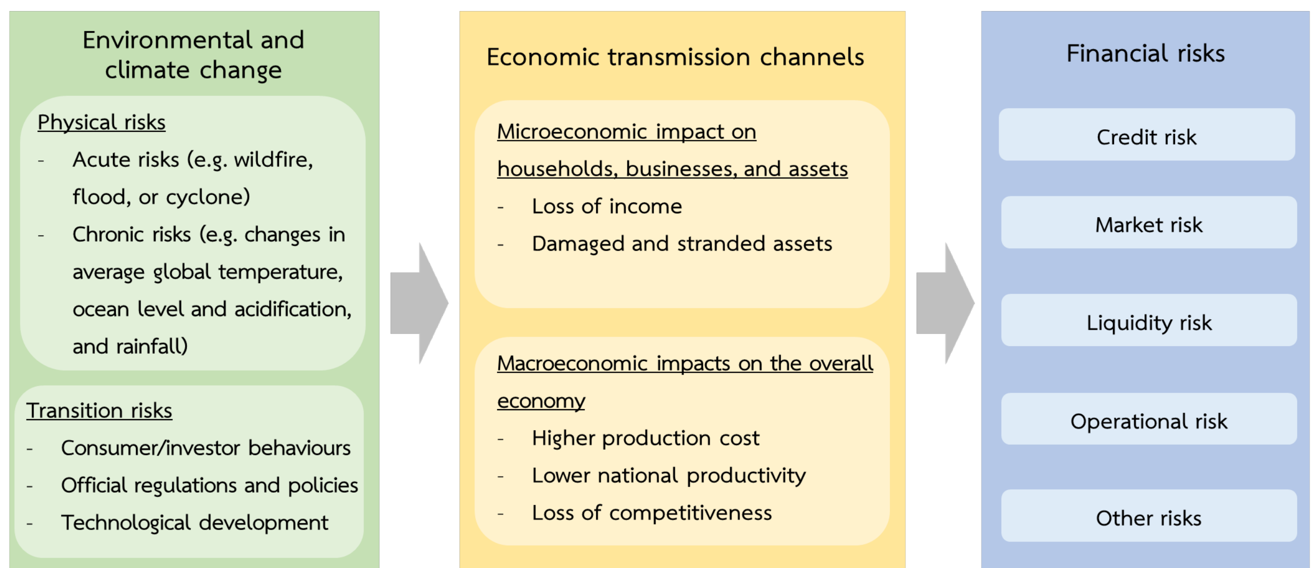
[9] Financial institutions can find information on good disclosure practice as per TCFD including examples of disclosure from G20 companies at the Sustainable Capital Market Development, Stock Exchange of Thailand (https://www.setsustainability.com/libraries/1052/item/tcfd-good-practice-handbook)

Appendix

Environmental risk transmission mechanism and examples of environmental impacts on financial risks[10]

Environmental changes may cause both direct and indirect impacts to various sectors in the economy, including household, business, and financial institutions. These impacts can occur in a variety of dimensions and could lead to systematic risks without a proper management in a timely manner.

Environmental risk transmission mechanism



Examples of risks to financial institutions and the corresponding guidelines[11]

1. Credit risk: Loan default can occur from clients that exposed to severe impact from environmental changes as they might not be able to generate adequate income to repay financial institutions.

   Guideline: Financial institutions should understand and assess the impact of environmental risks on their credit risk exposure by establishing policies and tools in identifying, assessing, monitoring, controlling, and reporting the impact of environmental risks throughout the credit cycle.

[10] Financial institutions may study potential environmental impacts on financial risks in further detail from the following report "Climate-related risk drivers and their transmission channels" by Basel Committee on Banking Supervision (https://www.bis.org/bcbs/publ/d517.pdf)

[11] Details of risk management practices as per principle 8 -11 of the "Principles for the effective management and supervision of climate-related financial risks" by Basel Committee on Banking Supervision (https://www.bis.org/bcbs/publ/d532.pdf)

2. Market risk: Physical or transition risks may cause volatility to prices of financial instruments with exposed underlying assets and may lead to financial losses for financial institutions.

   Guideline: Financial institutions should understand and assess the impact of environmental risks on the financial instruments in their portfolios by evaluating potential losses and volatilities as well as having in place a process to control the risks and adjust their investment strategies and portfolio allocation in line with the risks.

3. Liquidity risk: Natural disasters that create widespread loss could lead to sudden liquidity needs from clients or counterparties.

   Guideline: Financial institutions should understand and assess the impact of environmental risks on their net cash outflows. For example, the need for credit and deposit withdrawals may increase from clients who are impacted from environmental issues. This should be integrated as one of the factors for considering liquidity buffer.

4. Operational risk: Natural disasters such as floods may cause damages to financial institutions' assets and resources such as buildings, equipment, and personnel which may impact their business operations.

   Guideline: Financial institutions should understand and assess the impact of environmental risks on their ability to carry out normal business operations, particularly for critical business functions and integrate them as one of the factors when considering the business continuity plans.

5. Other risks such as:

   5.1 Strategic risk: Changes in government policies and regulations that reduce or forbid certain businesses may impact financial institutions' business plans, leading to losses in revenue and business opportunities.

   5.2 Reputational risk: Financing or providing financial services to businesses that cause damages to the environment will impact financial institutions' reputation.

   Guideline: Financial institutions should evaluate other risks that may occur from impacts of environmental risks and integrate them as part of the processes to set organizational strategies and risk management.

Attached questions – answers on the Policy Statement of the Bank of Thailand
Re: Internalizing Environmental and Climate Change Aspects into
Financial Institution Business

Dated 15 February 2023 (B.E.2566)

No.	Questions	Answers
1	How does the BOT expect financial institutions to tangibly apply the policy statement in accordance with the risk proportionality principle?	The BOT will commence progress evaluation in accordance with this policy statement from 2024 onwards by taking into account the different levels of risk materiality among various financial institutions. Self-Assessment exercise will be used for the progress evaluation in the early stage. To support practical adoption of this policy statement, the BOT will cooperate with the banking industry to develop an industry handbook within the first half of 2023.
2.	How does the BOT expect other companies in the financial business group to apply this policy statement?	The BOT encourages financial institutions to use this policy statement as a framework to elevate environmental actions of companies in the financial business group, in accordance with the risk proportionality principle. This will help set a quality standard for the environmental actions in the group. However, in cases where other financial regulators, such as the Securities and Exchange Commission or Office of Insurance Commission, have issued regulations or guidelines relating to internalizing environmental and climate change into the financial business specifically for their regulated sectors, companies within the financial business group under such regulators should abide by their regulators' regulations or guidelines.
3	Are foreign commercial bank branches subjected to this policy statement?	Foreign commercial bank branches must be able to demonstrate that their Thai branch's business conduct is aligned with this policy statement. The Thai branch may refer to their parent company's

No.	Questions	Answers
		policies, processes, and disclosure channels and apply them in Thai context as appropriate.
4	Are financial institutions required to hire external experts in verifying or reviewing environmental issues?	The BOT does not require financial institutions to hire external experts in verifying or reviewing environmental issues. However, financial institutions should evaluate the necessity in hiring external experts, especially for the high-risk and significant transactions, to ensure an appropriate quality of risk management, and address the needs of relevant stakeholders especially investors and the public.
5	What are the examples of standards that specify economic activities or financial products that are environmentally friendly, other than the ASEAN Green Taxonomy and Thailand Taxonomy?	Internationally accepted standards such as: - EU Taxonomy - Loan Market Association's Green Loan and Sustainability-Linked Loan Principles - International Capital Market Association's Green Bond and Sustainability-linked Bond Principles - Climate Bonds Initiative's Climate Bonds Taxonomy In this regard, financial institutions should consider standards that are appropriate for their transactions.
6	What does "counterparties" refer to in this policy statement?	Involved parties in financial institutions' normal business conduct such as loan, investment, and contractual obligations including non-primary business activities (e.g. procurement) that could be exposed to environmental risk materiality.
7	Can financial institutions implement environmental risk management at the entity level (clients or counterparties) rather than at the transaction level?	Financial institutions may carry out operations as practically appropriate. For example, the environmental risk monitoring process may be implemented on an entity level to reduce unnecessary procedures. However, the quality of the risk management process must be maintained in accordance with this policy statement.