GROUP ESG RISK POLICY

January 02, 2022

GROUP ESG RISK POLICY			
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1 Introduction

Environmental, Social, and Governance (ESG) related issues as well as the impacts they create, the opportunities they provide and risks that they generate are becoming more and more relevant for financial institutions. FAB Group recognizes the importance of incorporating ESG risks as part of the Enterprise Risk Management framework.

Managing ESG risks are just as important as opportunities in the pursuit of sustainable growth and transitioning towards a more ESG friendly environment.

FAB Group's ESG Risk Policy (ESGRP) is designed to integrate ESG risks within the Enterprise Risk Management framework while being fully aligned with the Group's ESG targets and the strategic business objectives of the Group.

1.1 Purpose

The purpose of ESGRP is to establish principles and guidelines for identifying, assessing, managing, monitoring, mitigating, and reporting ESG risks, throughout the FAB Group.

1.2 Objectives

The core objective of the ESGRP is to provide assurance to the Board of Directors, investors, regulators, and other stakeholders that ESG risks threatening the Group's business activities, achievement of its core values and purpose are addressed within an effective integrated risk management framework.

The ESGRP also defines the broad principles for the identification, assessment, and measurement, monitoring and reporting of ESG risks for all business units across the Group. It will act as a guide for embedding strong ESG risk awareness culture within the Group.

The more specific objectives for the ESGRP include:

- Establishing a reference guideline for identifying and assessing ESG risks across the Group
- Defining key ESG risk metrics and performance indicators for monitoring and reporting
- Developing ESG risk assessment tools and defining processes for onboarding of new clients, transactions, and vendors

The following objectives are covered by the ESG Risk framework description:

- Setting an effective ESG risk governance structure and oversight with clear responsibilities across the Three Lines of Defence (addendum to framework)
- Encouraging an ESG risk culture within the Group through building ESG risks awareness and understanding at all levels

1.3 Scope

ESG risks for FAB Group ("Group") arise from its internal business activities as a Company, from its counterparties and from its vendors. Therefore, it impacts a wide range of activities within the Group. There are other policies within the Group that currently address different aspects of ESG risks.

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This document serves as the umbrella policy for all ESG risk related topics. However, it does not explicitly address the ESG risks arising from the Group's internal activities as a Company. ESG risks arising from the Group's internal business activities as a Company are covered as part of the following:

- Group ESG Policy
- Group Environmental Policy
- FAB Employee Code of Conduct
- FAB Directors Code of Conduct

The ESGRP lays out the principles of ESG risk management and addresses, primarily, the indirect risks and impacts emanating from counterparties and vendors.

The following Group policies and documents, will be cross-referenced in the ESGRP wherever applicable:

- Enterprise Risk Management Policy
- Corporate and Investment Banking Group Credit Policy
- Personal Banking Group Credit Policy
- Group ICAAP policy
- Risk Appetite Policy
- Group Environmental Policy
- Group ESG Policy
- Group Compliance Policy
- Group Customer Due Diligence Procedure
- Group Procurement and Commercial Management Policy
- FAB Vendor Code of Conduct

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The scope of the ESGRP will be covered in the following four phases:

Phase	Phase 1	Phase 2	Phase 3	Phase 4
Timeline	2022	2022-23	To be decided	To be decided
Scope coverage across business products and operations	• Selected clients from Investment Banking (IB)[1] ○ Lending business (structured finance and syndicated loans, both funded and unfunded etc.) • Group's own investments[2] in bonds and equity • Group's internal supply chain[3] management with specific focus on vendors • Trade finance in all Group BUs	• Consumer Banking • Private banking • All Group Investment Banking (except FI/NBFI) and Corporate and Commercial Banking clients, with either one or more of the following products: ○ Strategic products (Debt capital markets, advisory and equity capital markets, securities services, and agency) ○ Lending business	• All Group Investment Banking and Corporate and Commercial Banking clients, with either one or more of the following products: ○ Supply chain finance ○ Cash management	• Commit to other relevant business activities with material ESG risks (based on the annual ESG risks materiality assessment results and decision by Group ESG Committee)

Note: Products and operations covered under each phase will continue to be in the scope of the subsequent phases. Above implementation plan is tentative and subject.

The ESGRP is applicable to all FAB Group entities (Head Office, domestic and international branches, and subsidiaries) across all countries of operations. Involved stakeholders are expected to know the framework and policy instruction and act accordingly.

In accordance with relevant local guidelines and requirements, the international entities will define specific addenda to address local regulatory and compliance requirements that are not covered by the ESGRP.

[1] *Phase 1 excludes Financial Institutions (FI/NBFI/CB & Supra). The geographic scope of the clients included in phase 1 will be limited to the UAE, USA, UK, France, Switzerland, Singapore, Hong Kong, Egypt, India, and China. An ESG risk assessment will be initiated during onboarding of new clients whereas existing clients will be assessed for their ESG risk rating as part of periodic credit reviews. Clients without credit line etc. will be assessed according to the Customer Due Diligence review cycle.*

[2] *Significant investments in bonds and listed equity will be assessed through external ESG ratings at the current stage. Private equity and securities, including advisory services and supply in Private Banking Group and FAB Securities, are planned for later stages of the ESG roadmap.*

[3] *During the early phase of the ESGRP implementation, the Strategic Vendor Management team will conduct ESG risk assessment on the top 100 companies with the highest PO values based on the last two years transactions.*

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1.4 Control and Maintenance of the Policy

This Policy will be approved and issued by the Board Risk & Compliance Committee under the authority delegated to it by the Board of Directors (BoD) of the Group.

The ESGRP is intended to be an evolving document as new guidelines and regulations are introduced across different jurisdictions. As the area of ESG risks management evolves and in line with the evolution of Group activities, it is anticipated that the existing policy may require amendments and/or inclusions.

The ESGRP will be reviewed once every year or more frequently (if required), to ensure it is relevant. All amendments, additions or deletions to the Policy will be subject to version control and approvals prior to implementation.

The approved revisions will be provided in both hard copy form and the electronic version (with access restricted to relevant stakeholders). All stakeholders will be immediately informed through an internal memorandum which may also be communicated via email.

The Head of ESG Risk team (HoESGR) shall hold the master register of amendments and records of the approved amendments. A Version Register will be maintained by HoESGR that shows the Policy version information relating to the version number, version date, and section amended (as per Document Control Table at the beginning of this document).

The ESGRP must not be copied or revealed to third parties without the written permission of the Group Chief Risk Officer and by the Executive Management (if required). Unauthorized sharing of this Policy (both hard copies and electronic copies) with individuals and entities outside FAB is strictly prohibited. Violators of this Policy are liable to disciplinary action.

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1.5 Abbreviation

Abbreviation	Description
BoD	Board of Directors
CEC	Credit Execution Committee
ERM	Enterprise Risk Management
ESG	Environmental, Social and Governance
ESGRP	ESG Risk Policy
ESG-SFC	ESG Risk and Sustainable Finance Committee
G-ESGC	Group ESG Committee
GOFRC	Group Operational and Fraud Risk Committee
GCC	Group Compliance Committee
GRC	Group Risk Committee
UNEP FI	United Nations Environment Programme Finance Initiative
NGFS	Network for Greening the Financial System
TCFD	Task Force on Climate related Financial Disclosures
UNGC	United Nations Global Compact

1.6 Structure of the Policy

The framework description has been divided into the following areas:

- Section 1 – Introduction
- Section 2 – ESG risk identification
- Section 3 – ESG risk assessment and measurement
- Section 4 – ESG risk mitigation
- Section 5 – ESG risk reporting and monitoring
- Support 6 – Contacts
- Support 7 – Annexures

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2 ESG risk identification

2.1 Relevant laws, regulations, and external standards

Central banks and policymakers where FAB Group operates are becoming interested in understanding how the banking sector is effectively managing and monitoring ESG related risks within their operations, particularly in response to climate change challenges, socio-economic topics, and governance transparency.

When setting this policy, the Group has considered relevant legislations and guidelines, which are updated from time to time. Some of these guidelines include, but are not limited to:

- Bank of England: Enhancing banks' and insurers' approach to managing the financial risks from climate change
- Monetary Authority of Singapore: Guidelines on environmental risk management
- European Central Bank: Guidelines on climate-related and environmental risks

Country specific policy addendums are used for the countries where relevant e.g., to address national level ESG legislations.

2.2 Definition of ESG Risk and Transmission Channels

ESG risks are manifested within the principal risks that are defined under the Key Risk Taxonomy of Enterprise Risk Management Policy and broadly defined as any negative financial and non-financial impacts to the Group stemming from the current or progressive impacts of Environmental, Social and Governance factors on the Group's internal business activities as a company, its counterparties and vendor management.

ESG risks can emerge from the customers' activities, inherent from sector-specific activities, externally from the stakeholders they interact with (e.g. customers, regulators, shareholders, etc.) and the countries we operate in. These risks are not bound by timelines and can occur within the short, medium, and long-term. ESG risks are broadly classified into Direct and Indirect risks as defined below. As mentioned in the section on policy scope, Direct risks are primarily managed by the Group ESG team and Indirect Risks are managed by ESG Risk team under ERM:

1. ***Direct ESG Risks*:** These are defined as ESG related risks that result from the Group's internal operations as a Company and the associated physical assets. The impact of Direct ESG risks would be felt by the Group through an ESG event that causes a negative financial or non-financial impact through a direct impact on the operational infrastructure of the Group's office premises or due to an adverse reputational impact resulting from the Group not complying with expected standards of Group ESG practices. Some examples of Direct ESG Risks are given below:
    a. The risk of capital cost and damage in the Group's properties located in Southeast Asian countries that are at increasingly becoming at risk of flood, earthquake, and typhoon

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b. The risk of reputational damage from failing to meet any emission targets and/or increasing operating cost for carbon credits to offset residual emissions
c. The risk of reputational damage due to work-place accidents, imbalanced working hours, and high turnover rates
d. The risk of reputational damage due to incidents from bribery, corruption, money laundering and fraud

Direct ESG risks will be addressed as part of the existing internal governance and sustainability framework. The Group ESG team will be responsible for managing Direct ESG risks of the Group's internal activities.

2. ***Indirect ESG Risks***: These are defined as ESG related risks that are indirectly affecting the Group's financial performance and reputation due to an ESG related impact on its lending counterparties, investment exposures, funding activities and vendor/ supply chain. The ESG Risk team will be responsible for managing Indirect ESG risks.

The ESGRP instructions along with risk appetite metrics and risk assessment tools primarily aim to identify, assess, and manage the indirect ESG risks emanating from counterparties and vendors.

2.2.1 Environmental risks

Environmental risks refer to any negative impact to the Group's premises, reputation and credit exposures to counterparties that may potentially contribute to or be affected by climate change and other forms of environmental degradation (such as air pollution, water pollution, scarcity of freshwater, land contamination, biodiversity loss and deforestation).

Financial impact on the Group's portfolio and activities from climate change can materialized through two channels:

a. Physical risks result from climate change and environmental factors that are event driven (acute) or longer-term shifts (chronic). For example: risk of default and/or financial loss by the exposure to counterparty due to physical risks (earthquake, flood, heatwaves, wildfires, rising sea level etc.) that may damage counterparty's production facilities and disrupt value chains.
b. Transition risks can arise from the shift to a low-carbon economy. For example: risk of financial loss by the exposure to counterparty that may be negatively affected by the shifts in market sentiment, customer demand and technological advances, and tightening regulations that would lead to rating downgrades and increasing fines.

2.2.2 Social risks

Social risks refer to any negative impact to the Group's business activities and reputation as a company, its financing to counterparties and sourcing of vendors due to social factors, such as violation of human rights, unfair labour practices, unsafe working conditions and mishandling of customer privacy. For

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example: the risk of default and/or financial loss by the exposure to counterparties who are exposed to potential fines and reputational damage due to fatalities and incidents in the workplace.

2.2.3 Governance risks

Governance risks refer to any negative impact to a Group's business activities and reputation as a company, its financing to counterparties and sourcing of vendors due to weak governance structure and failures in business ethics. For example: the risk of default and/or financial loss by the exposure to counterparties who are affected by the disruptions in business, reputational damage, and regulatory fines due to acts of negligence from the Board.

The ESG risks crosscut the principal risk categories and can materialize from both direct (through operation of the Group's own premises, infrastructure and organizational culture) and indirect (the financial services and support that the Group provides to its customers who may be exposed to ESG risks) channels.

The below schematic diagram shows how ESG risk is mapped across the principal risk categories:

Figure 2. 1: ESG risk mapping

Risk Types	Categories	Impact type	Credit risk	Market risk	Liquidity risk	Compliance risk	Operational risk	Reputatio -nal risk	Strategic risk
Environmental	Physical risk	Direct impact:							
		Indirect impact:							
	Transition risk	Direct impact:							
		Indirect impact:							
Social	Human capital development	Direct impact:							
	Occupational health and safety	Direct impact:							
		Indirect impact:							
	Human rights and Labour practices	Direct impact:							
		Indirect impact:							
	Community	Direct impact:							
		Indirect impact:							
	Customer protection, Data security	Direct impact:							
Governance	Board structure, diversity & independence	Direct impact:							
		Indirect impact:							
	Executive remuneration	Direct impact:							
	Reporting and transparency	Direct impact:							
	Business ethics	Direct impact:							

For each of the impacted principal risk categories from direct channels, existing risk policies and controls in place are expected to mitigate ESG risks. ESGRP is therefore established to mitigate the indirect ESG risks aligned with the current risk management framework and internal governance structure.

2.3 Risk Appetite Statement

The Group's ESG risk appetite is aligned with the enterprise wide risk appetite framework. The risk appetite has been defined using a set of quantitative metrics (i.e. key risk metrics and performance

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indicators) and qualitative criteria. The risk appetite statement will be reviewed and approved by the Board on an annual basis and monitored on a quarterly basis.

2.3.1 Quantitative Risk Appetite Metrics

Quantitative risk appetite metrics comprise the following:

- **Key ESG Risk Indicators**: These risk appetite metrics establish the Group's risk tolerance to indirect ESG risk emanating from exposures to counterparties and vendors from high-risk sectors, geographies and third party/ internal ESG risk ratings and cascaded down by products and business functions.
- **Key ESG Performance Indicators**: These risk appetite metrics establish the Group's risk tolerance to Direct ESG risk. The key performance indicators are established to monitor among other things the performance of the Group's own emissions, social responsibility, and governance structure.

The risk metrics and performance metrics used are deemed to be appropriate for the current risk profile of the Group and will be updated on an annual basis.

Note: Please refer to Annexure I for key risk metrics and performance indicators (also see Group ESG Policy and Framework).

2.4 Qualitative Risk Appetite Criteria

FAB Group is committed to identifying, evaluating and managing ESG risks in lending, investment, funding and vendor management processes. On top of the standard Know-Your-Customer and Group Customer Due Diligence process, the Group will identify countries, sectors and activities of heightened sensitivity to ESG risks which could negatively impact the Group based on prior experience of engagement with the customer and external third party ESG risk assessment from credible sources. Based on this, the appetite of the Group towards negative screening list, ESG critical activities and high ESG risk areas are defined below:

2.4.1 Negative screening list

The Group will not knowingly engage with companies or customers including:

1. Unsuccessful resolution of ESG issues on previous engagements with customer
2. Violators of UN Global Compact principles[4]
3. Violates of national or international legislation[5]
4. Potential negative impact on critical natural habitats and areas protected including e.g. UNESCO World Heritage Sites
5. Illegally infringe ownership of land or resources without Free, Prior and Informed Consent (FPIC)

[4] *No alleged high-risk breaches of the principles over the last two years.*
[5] *As an example, adherence to UK Modern Slavery Act Policy.*

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6. Obligors on the Office of Foreign Assets Control (OFAC) blacklist
7. Classified as severe risk under the ESG risk assessment tool and approved by the relevant committees.

Note: Please refer to Annexure II for the UN GC Principles.

2.4.2 ESG critical activities

In addition, the Group will not knowingly engage in the activities from the "ESG Critical Activities", while not illegal, are not aligned with Group's values, principles and code of conduct if the revenue threshold is not met.

The Group can engage with customer under one of the following conditions as long as the purpose of the transaction and new engagement is in accordance with the Group's vision and principles in order to help the customer to rely increasingly more on ESG friendly business areas:

1. Critical activities make up less than 25% of the total revenue
2. If the relevant transaction is expected to reduce the negative ESG impact of a critical activity, e.g. an impact on the environment, and
3. Risk mitigation actions in place[6].

If a transaction is under the Group's Sustainable Finance Framework, other requirements are in place such as restrictions on the use of proceeds from sustainable finance transactions.

Note: Please refer to Annexure II for the ESG critical activities.

2.4.3 High ESG risk areas

The Group recognizes that certain sectors and activities are more likely to be exposed to higher ESG risks. The Group will actively engage with current and prospective clients even if the client is classified as high and severe risk as part of ESG risk assessment process. The ESG Risk/Credit team, as appropriate, will conduct enhanced due diligence assessment, reviewing the client's exposures to high ESG risk sectors, comparing with performances of peer companies, and reviewing risk mitigation actions in accordance with principles outlined in section 4.

The Group identifies sectors particularly susceptible to ESG risks based on external sources, along with additional inputs from internal portfolio analysis and monitors significant changes in sector performance on a periodic basis.

Note: Please refer to Annexure II for high ESG risk sectors and high and very high ESG risk countries.

[6] *Will require an action plan attached to the transaction, see section 4.*

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3 ESG Risk Assessment and Measurement

3.1 Materiality assessment of ESG risks

Materiality assessment is an exercise conducted to gather insight on exposure and materiality of different ESG risks for the Group and to proactively manage the identified risks. This exercise helps in identifying the critical ESG risks and understanding which issues are most material or relevant to business and stakeholders. It is aligned with the principles of materiality as described in Global Reporting Initiatives (GRI) standards and recommendations of Task Force on Climate related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB).

The ESG Risk team holds workshops and meetings with key stakeholders within the Group to conduct the materiality assessment. The materiality assessment will be done annually on two dimensions as outlined below.

- Likelihood: Rare, Likely and Highly likely.
- Severity (impact to business success and financial importance): scaling of low, moderate, high, and severe is inspired by the Operational Risk Assessment Matrix.

Table 4. 1 Scaling of severity levels

Scale	Customer base	Staff affected
Low	<1%	<10%
Moderate	1% - 10%	10% - 20%
High	10% - 20%	20% - 50%
Severe	> 20%	> 50%

Note: Please refer to Annexure III for illustrative Materiality Assessment.

The outcome from the Materiality Assessment will be presented to the Group ESG Committee for review and approval.

3.2 ESG Risk Assessment at Counterparty, Transaction and Vendor Level

The Group is committed to identifying, evaluating and managing ESG risks in lending, investment and vendor management processes. As outlined in Group ESG Policy and Group Environmental Policy, the Group seeks to identify and manage any strategic or reputational risks arising from environmental and social impacts associated with Group's lending and commercial activities.

Furthermore, the Group is a signatory to Equator Principles (EP), a risk management framework adopted by financial institutions for determining, assessing and managing environmental and social risks in project finance.

ESG risk assessment at counterparty and transaction level begins with front line units through negative screening and determining the ESG risk rating of the customers through ESG due diligence at the credit life cycle and vendor management process. Trade Finance will follow a simple ESG due diligence approach, which considers the transaction's alignment with the UN SDGs and ICC Framework for

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Sustainable Trade. The parties involved in the transaction will also be assessed from an ESG risk perspective through reviewing their ESG score assessed by credible external rating agencies.

When more clients and products are being taken into scope, the processes described below will be adjusted accordingly.

3.2.1 ESG risk assessment tool

ESG risk assessment tool includes quantitative and qualitative assessments, which collectively, provide a combined ESG risk rating outcome for counterparties. This assessment is completed at the onboarding phase of new clients, vendors and periodic credit review.

Quantitative assessments rely on a counterparty's ESG risk ratings provided by credible external ESG rating agencies. Meanwhile, the qualitative assessment is an internally developed ESG questionnaire that assesses the counterparty's current ESG policies, commitments and practices in effectively managing ESG risks.

The combined ESG risk rating from quantitative and qualitative assessments will categorize counterparties in three ESG risk categories:

1. Acceptable risk: No further action, approving the counterparty's relationship and transaction, if transactions comply with requirements in section 2.4. The ESG Risk team will undertake a sample check of acceptable risk clients to confirm the combined ESG risk rating and check for those with conflicting external and internal ratings.
2. High risk: Conditionally approved, with well founded motivation (more in-depth due diligence) and reasoning, encouraging the client to improve its ESG risk profile with agreed-upon mitigation action plan, performance-enhancing measures or addition of loan covenants, conditions or other requirements attached to the onboarding or transaction.
3. Severe risk: No engagement and exit from the client or vendor relationship, unless overridden by relevant committee.

Note: Please refer to Annexure IV for the ESG rating model.

3.2.2 ESG risk assessment of counterparties during life cycle

Onboarding of new clients

The due diligence for onboarding new clients (including non-borrowing and borrowing clients) is conducted at a parent company level if applicable[7]. The front line units will conduct an ESG risk assessment for the counterparty, covering negative screening, external ESG rating and internal questionnaire with adequate evidence of proof.

[7] *If the counterparty is a subsidiary and belongs to the same sector as the parent company, then an ESG risk assessment will not be performed at the counterparty level. The same ESG risk score of the parent company will apply (if available). If no parent company exists, then complete the ESG risk assessment at the individual counterparty level.*

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New transactions:

New transaction will be assessed against the negative screening exclusions and ESG critical activities, as outlined in section 2.4. The front line units will complete these assessments with adequate evidence of proof.

ESG risk assessment aligned with periodic credit reviews and/or periodic customer reviews:

When performing periodic credit reviews for clients with credit exposures, front line units will conduct an ESG risk assessment for high ESG risk sector clients and governmental clients during periodic credit reviews. Ad-hoc events in between credit renewals can trigger an ESG risk re-assessment in cases where potential adverse effects and lower ESG ratings were identified for the client.

ESG risk assessment for borrowing clients will be conducted during periodic reviews if the following scenarios exist:

1. No previous historical record of an ESG risk rating and their sector is a 'High' ESG risk, or it is a governmental entity
2. The last approved ESG risk rating is high or severe
3. The last approved ESG rating is 'Acceptable' and more than 6 months old

In line with the Customer Due Diligence review cycle, periodic review and monitoring for non-borrowing clients will be conducted based on client's last ESG risk rating for high ESG risk sector clients and governmental clients, with the exception of trigger events:

Table 4. 2 ESG risk review cycle for non-borrowing clients

Risk categories	Review cycle
Acceptable	At least every 5 years
High	At least every 2 years
Severe	At least annually

ESG risk assessment for ad-hoc event driven reviews:

The ad-hoc event driven reviews enables the Group to identify customers with potential/ emerging deterioration in its ESG risk profile, pro-actively monitor its portfolio and discreetly approach the customer to help remediate potential ESG risk concerns.

Front line units as their role under the 1st line of defense will identify new ESG risk incidents for the customer through regular dialogue with customer and/or third party information, and perform ESG risk assessment to update the ESG risk rating.

The ESG Risk team will perform periodic monitoring for any adverse changes in external ESG ratings for the customer to identify customers with potential ESG issues and to take appropriate and timely corrective action plans. The event-driven alerts are categorized as:

1. Green alert: No further action, if there are unsubstantial changes in external ESG rating.

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2. Amber alert: The ESG Risk team will classify the client under watch list and monitor closely, if the external ESG rating changes from acceptable risk to high risk category and potential changes in existing ESG related regulations and/or emerging new ESG regulations that will have a direct impact to client's business activities are expected.
3. Red alert: The ESG Risk/Credit team, as appropriate, will raise a flag to front line units for an update on ESG risk assessment, if the external ESG rating changes to severe risk level and ESG related risk incidents materialize for the customer.

3.2.3 ESG risk assessment for investments

The ESG risk assessment for investments will rely on data provided by external ESG risk rating agencies due to the limited direct relationship with investees compared to other counterparties.

The ESG risk score for investees will be based on an average score sourced from a number of ESG rating agencies and categrosied into acceptable, high and severe. The investees' combined ESG risk score will be added to a watchlist for monitoring purposes with a special focus on high and severe rated securites and refreshed every 6 months as well as reported to CEC.

3.2.4 ESG risk assessment for vendor management

ESG risk assessment for vendors of critical activities/ services will be performed by the Strategic Vendor Management team, when onboarding new vendors. Existing vendors will be evaluated once a new transaction takes place. Assesment of new and existing vendors[8] will only be triggered if the risk assessment outcome of the Inherent Risk Questionnaire (IRQ) is 'Medium High' or above. After that ESG risk assessment will be updated according to a three year cycle.

Note: Please refer to Annexure V for process illustrations.

3.3 Stress testing and Scenario analysis

Central banks and policymakers located in areas where FAB Group operates, such as EBA/ECB, BoE, MAS and HKMA, have higher expectations from banks on integrating climate-related risks in stress testing and scenario analysis. This helps evaluate the bank's financial resilience to climate-related risks and opportunities. Due to modelling challenges with respect to relatively longer time horizons, limited historical observations and data availability, the climate stress testing and scenario analysis however remains work in progress.

The Group has taken a robust scenario driven and factor push approach for stress testing exercise, combining quantitative and qualitative methodologies to estimate forward-looking ECL impacts adjusted with stakeholder expectation on managing the ESG risk. The purpose for the stress testing tool is to understand the potential impacts on selected portfolios, enhance the methodology, and meet TCFD reporting and supervisor and central bank requirements going forward.

[8] *If the counterparty is a subsidiary and belongs to the same sector as the parent company, then an ESG risk assessment will not be performed at the counterparty level. The same ESG risk score of the parent company will apply (if available). If no parent company exists, then complete the ESG risk assessment at the individual counterparty level.*

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Following are the quantification steps to be followed to conduct stress testing exercise:

Step 1: Design and update scenario library

Scenario library is a living document containing potential external and internal ESG scenarios and their priority level, covering both the climate-risk related scenarios and emerging risk scenarios for social and governance factors. The scenarios will be shortlisted based on the alignment with regulatory recommended scenarios, priority level and the availability of longer horizon estimates for macroeconomic variables to stress the parameters of Expected Credit Loss (ECL) modelling.

Note: Please refer to Annexure VI for examples of stress scenarios.

Step 2: Quantitative assessment

The modelling of ESG related (including physical and transition risks for climate change) risks is in its infancy. For a start, the Group has taken a simple approach based on external research (NGFS, UNEP FI) and utilization of internal capabilities to estimate the financial impacts of climate change limited to high environmental risk sectors (such as energy, power utilities, mining, transportation, manufacturing, buildings and construction):

1. Identify the key risk drivers of the shortlisted climate change related scenarios on a combination of scenario (GDP forecasts for 30 years horizon available from NGFS) and factor push approach (sector and regional level financial impact on balance sheet or total revenue)
2. Link the key drivers to the transmission functions:
    - Obligor Risk Rating (ORR): Downgrade the credit rating of counterparties who operate in ESG vulnerable sectors by certain notches down and/or historical performance between ORR and EBITDA
    - IFRS 9 ECL model: Revise the baseline GDP forecast for macroeconomic variables used in IFRS 9 modelling
3. Revise the Through-The-Cycle (TTC) PD and consequent Point-In-Time (PIT) PD curves
4. Estimate the net ECL impact under the revised PD curves

Step 3: Qualitative assessment scorecard

The qualitative assessment scorecard is used to understand the management views of actions taken on managing ESG risks and to fine-tune the outcomes of the quantitative assessment (mentioned in step 2) based on the Group's current risk management practices with respect to ESG risks and plans for improvement.

The set of parameters are assessed under qualitative assessment and have been classified as "Control" or "Risk" parameters on a rating scale of 1 to 10 with 1 being Strongly agree and 10 being Strongly disagree.

1. Collect response on the set of parameters from senior management
2. Derive an average score for each parameter
3. Calculate overall weighted average score for ESG risk

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4. Derive a mapping table in line with the rating scale to adjust the outcomes of the estimated credit loss due to ESG risks under the stress scenarios
5. Determine the bucket in accordance with overall average weighted score and apply the adjustment factor for the respective bucket to identify the final net financial impact under ESG stress scenarios

While the stress testing exercise will follow ICAAP process and timelines, the estimated impact on ECL and consequent capital shortfall will however not be included in the Pillar II capital charge due to the early stage of stress testing methodology and inclusion of qualitative assessment.

The effort is work in progress, and will evolve over the years as data, taxonomy, assumptions, resources, and insights improve.

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4 ESG Risk Mitigation

In line with risk mitigation principles outlined in Enterprise Risk Management policy, the Group adopts following measures and controls as part of risk mitigation for the identified ESG risks:

1. Monitoring vulnerable sectors, geographies and customers, and identifying negative screening and ESG critical activities list as part of ESG risk appetite framework
2. Offering of sustainable finance products, such as Green Bonds, to finance projects that have positive environmental and climate benefits
8. Engaging with high and severe ESG risk counterparties with mitigation plans to assist in reducing customer's exposures to ESG risks and transition towards sustainable business practice.

Front line units, based on discussions with the customer, will recommend risk mitigation action plans to improve customer's ESG risk profile when engaging with high ESG risk counterparties or if the activity is ESG critical, but can be contained with a risk mitigating action plan. This will be adequately documented as part of process documentation and reviewed by the ESG Risk/Credit team, as appropriate.

ESG Risk/Credit team, as appropriate, will review the recommended mitigation actions plans with respect to following principles:

1. Objective: A well-defined set of actions that will improve customer's ESG profile and ensure to stay away further critical activities
2. Direct: To have a direct impact on the customer's business activities and revenue model
3. Measurable: To touch a material portion of the total revenue, so that the revenue share of non-critical activities reaching revenue threshold of 75%
4. Commitment: Backed by buy-in from senior management to committing objectives
5. Timely: A clear timeline with a target date.

The status of the ESG risk mitigation plans must be monitored and communicated to ESG-SFC for corrective actions to be taken.

Note: Please refer to Annexure VII for examples of risk mitigation actions.

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5 ESG Risk Reporting and Monitoring

5.1 Annual disclosures in line with international standards

The Group strives to disclose all relevant sustainability and ESG related information to external stakeholders via Group's annual reporting on its webpage. Going forward, more granular data and information will be provided in the external reports aligned with national and international guidelines.

5.2 Internal reporting and monitoring process

In line with ERM reporting system under Enterprise Risk Management Framework, the ESG Risk team will prepare following reports to internal stakeholders on a frequent basis:

Table 6. 1 List of internal reports[9]

Stakeholders	Reports	Content
Board committees Group ESG Committee	• ESG committee deck	○ A detailed pack with portfolio breakdown by ESG ratings, sectors, geographies, and performance of key risk metrics, including compliance against risk appetite and KPIs ○ Ad hoc outcomes of the stress testing and scenario analysis ○ Ad-hoc analysis on sector/ geography composition ○ Ad-hoc impact analysis of new ESG risk regulation and trends ○ Highlights on mitigation measures/action plans needed to manage high and severe risk customers ○ Summary of watch-listed accounts
ESG Risks & Sustainable Finance Committee and internal monitoring reporting	• Portfolio breakdown by ESG ratings for clients and credit transactions, investment, and vendors	○ Exposure by combined ESG ratings, external ratings (Rep-Risk Index), sectors, booking locations and geographies
	• Monitoring report on watch-listed accounts	○ Monitoring of high and severe accounts by their exposure, credit quality, sector, and geography, and mitigation measures
	• Watchlist reporting on significant external ESG rating changes for clients, investments, and vendors	○ Track record of external rating ○ Any adverse news and/or incidents on the company
	• Watchlist reporting on significant external ESG rating changes for sectors and geographies	○ Track record of external rating in sectors and geographies
	• List of accounts for enhanced due diligence	○ Number of conducted due diligence assessments, and breakdown by ESG risk level
	• Ad-hoc reports	○ Impact analysis on emerging ESG risk related laws and regulations ○ ESG macro trends

[9] *Country-level reports will be prepared for the KRIs as per local regulatory requirements.*

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6 Contacts

In case there are questions on the ESGRP, please contact

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7 Annexures

7.1 Annexure I: Illustrative list of key risk metrics and performance indicators

Table 7. 1: Risk Appetite Metrics

#	Risk metrics	Phase	Monitoring*	Unit
1	Credit concentration limits to counterparties** in high*** ESG risk sectors[10]	Phase I	Monitoring	%
2	Credit concentration limits to counterparties** in high*** ESG risk countries[11]		Monitoring	%
3	Credit concentration limits to corporate counterparties by Peak RepRisk Index		Monitoring	%
4	Credit concentration limits for corporate portfolio by Peak RepRisk and G percentage of the Peak RepRisk Index		Monitoring	%
5	Critical activities/services concentration limit to high-risk vendors		Monitoring	%
6	Deposit concentration limits by high ESG risk countries	Phase II	Monitoring	%
7	Investment concentration limits in high ESG risk sectors		Monitoring	%
8	Investment concentration limits in high ESG risk countries		Monitoring	%
9	Investment concentration limits to high-risk counterparties by Peak RepRisk Index		Monitoring	%

*Risk appetite metrics will be monitored during the roll-out of the ESG risk framework and policy in 2022. At the end of 2022, the monitored metrics will be reviewed for risk appetite statements, as deemed relevant and applicable will be reviewed and approved by the Board on an annual basis.
** Governmental entities will undergo individual client ESG risk assessments, however, are not included in the risk metrics used for monitoring as the government sector is not ESG risk assessed by current source.
*** Includes high and very high risk categories as applicable.

Table 7. 2: Key Performance Indicators for the Group's internal business activities

Performance indicators are pending publication of the Group ESG Strategy Policy and Framework.

7.2 Annexure II: UN GC Principles, ESG critical activities and high ESG risk sectors

Table 7. 3: United Nation Global Compact principles

Category	Principles	Definition
Human Rights	Principle 1	Businesses should support and respect the protection of internationally proclaimed human rights
	Principle 2	Make sure that they are not complicit in human rights abuses
Labour	Principle 3	Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining
	Principle 4	The elimination of all forms of forced and compulsory labor
	Principle 5	The effective abolition of child labor
	Principle 6	The elimination of discrimination in respect of employment and occupation
Environment	Principle 7	Businesses should support a precautionary approach to environmental challenges
	Principle 8	Undertake initiatives to promote greater environmental responsibility

[10] *Sectors ESG risk profiles are aligned with the European Bank for Reconstruction and Development (EBRD) Environmental and Social Risk Categorization List. The list is designed to provide credit officers within Financial Institutions (FIs) with a guide to the typical level of inherent E&S risk for particular business activities.*
[11] *Based on Global Risk Profile Score and is subject to revision in case the source changes*

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	Principle 9	Encourage the development and diffusion of environmentally friendly technologies
Anti-corruption	Principle 10	Businesses should work against corruption in all its forms, including extortion and bribery.

Table 7. 4: ESG Critical activities

Activities:
All restricted activities under the Corporate & Investment Banking Group Credit Policy (CIB GCP)
All excluded activities under Group Customer Due Diligence procedure
Tar sand extraction
Fracking
Ultra-deep-sea drilling
Arctic drilling
Thermal coal
Palm oil, soy, and timber
Landfill without gas capture
Waste incineration without energy capture
Animal mistreatment
Adult entertainment
Hazardous substances
Speculative transactions
Predatory lending
Hostile takeovers

Table 7. 5: High ESG risk sectors by EBRD sector classification

Sector	Sub-sector	NACE code
Agriculture, forestry, and fishing	Crop and animal production, hunting and related service activities	1
	Fishing and aquaculture	3
	Forestry and logging	2
Construction	Civil engineering	42
	Construction of buildings	41
	Specialized construction activities	43
Electricity, gas steam and air conditioning supply	Electric power generations, transmission, and distribution	35.1
	Production of electricity	35.11
	Transmission of electricity	35.12
	Distribution of electricity	35.13
	Manufacture of gas; distribution of gaseous fuels through mains	35.2
	Manufacture of gas	35.21
Manufacturing	Manufacture of basic metals	24
	Manufacture of chemicals and chemical products	20
	Manufacture of coke and refined petroleum products	19
	Manufacture of electrical equipment	27
	Manufacture of fabricated metal products, except machinery and equipment	25
	Manufacture of leather and related products	15
	Manufacture of other non-metallic mineral products	23
	Manufacture of other transport equipment	30
	Manufacture of paper and paper products	17
	Manufacture of rubber and plastic products	22

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	Manufacture of textiles	13
	Manufacture of basic pharmaceutical products & pharmaceutical preparation	21
	Manufacturing of wearing apparel	14
Mining and quarrying	Extraction of crude petroleum and natural gas	6
	Mining of coal and lignite	5
	Mining of metal ores	7
	Mining support service activities	9
	Other mining and quarrying	8
Transportation and Storage	Air Transport	51
	Land transport and transport via pipelines	49
Water supply	Remediation activities and other waste management services	39
	Sewerage	37
	Waste collection, treatment, and disposal activities; materials recovery	38
Wholesale and retail trade	Retail sale of automotive fuel in specialized stores	47.3
	Wholesale of solid, liquid, and gaseous fuels and related products	46.71
	Wholesale of metals and metal ores	46.72
	Wholesale of chemical products	46.75
	Wholesale of waste and scrap	46.77

Table 7. 6: ESG risk countries

ESG index country.xlsx

7.3 Annexure III: Materiality Assessment

Template for Materiality Assessmer

7.4 Annexure IV: ESG rating model

Table 7. 7: ESG risk rating structure

Tools	Definitions	Weights	Score range
Internal ESG risk assessment tool	• Internal risk assessment tool based on expert judgment and questionnaire	33,3% (Else 50%, in absence of one of the external ESG scores or 100% if both absent)	0 to 100 (higher the value, the higher the risk)
RepRisk	• Algorithm web-based platform for monitoring customer's ESG risk and violations of international standards (more than 150k companies)	33,3% (Else 50%, in absence of Refinitiv)	0 to 100 (higher the value, the higher the risk)
Refinitiv	• Refinitiv: Data driven ESG score based on publicly available information for 9k companies	33,3% (Else 50%, in absence of RepRisk)	0 to 100 (higher the value, the lower the risk)
		Combined ESG Score:	0 to 100 (higher the value, the higher the risk)

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Risk category	Score range	Actions
Acceptable	0 – 49	No further action is required
High	50 – 69	Engagement is subject to risk mitigation action plans in place
Severe	70 - 100	No engagement/ exit from the customer or vendor, unless overridden by relevant committee

ESG Due Diligence Questionnaire.xlsx

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7.5 Annexure V: ESG risk assessment process illustration

Figure 7.1: ESG risk assessment process for onboarding of new clients (borrowing and non-borrowing) that are high ESG risk sector clients and/or governmental entities

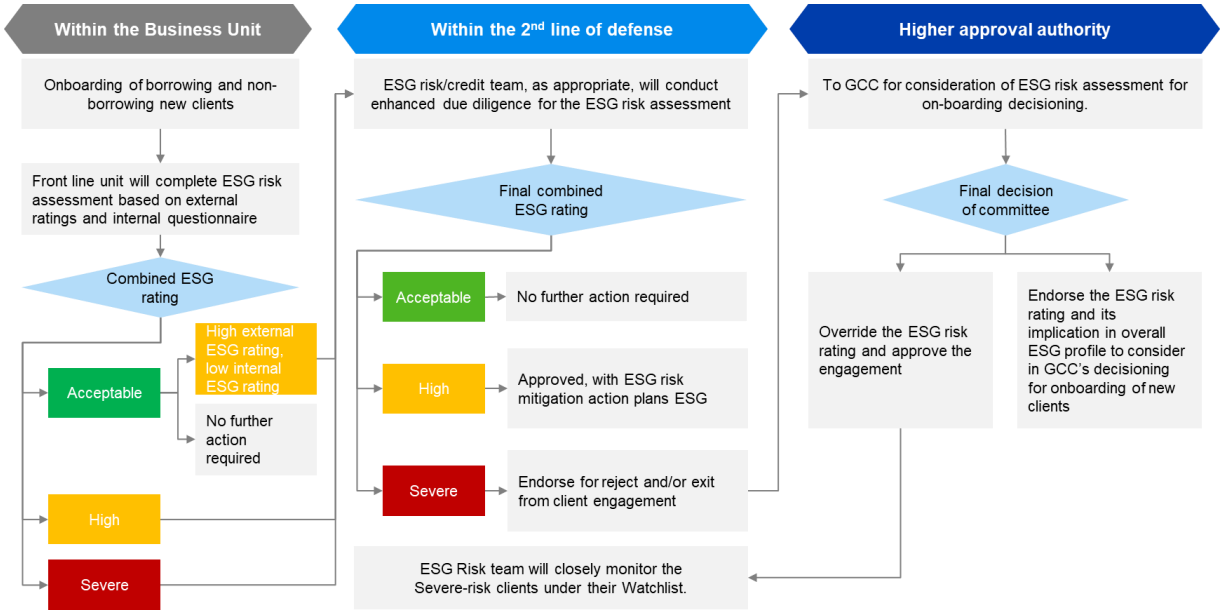

Figure 7.2: ESG risk assessment process for new transactions

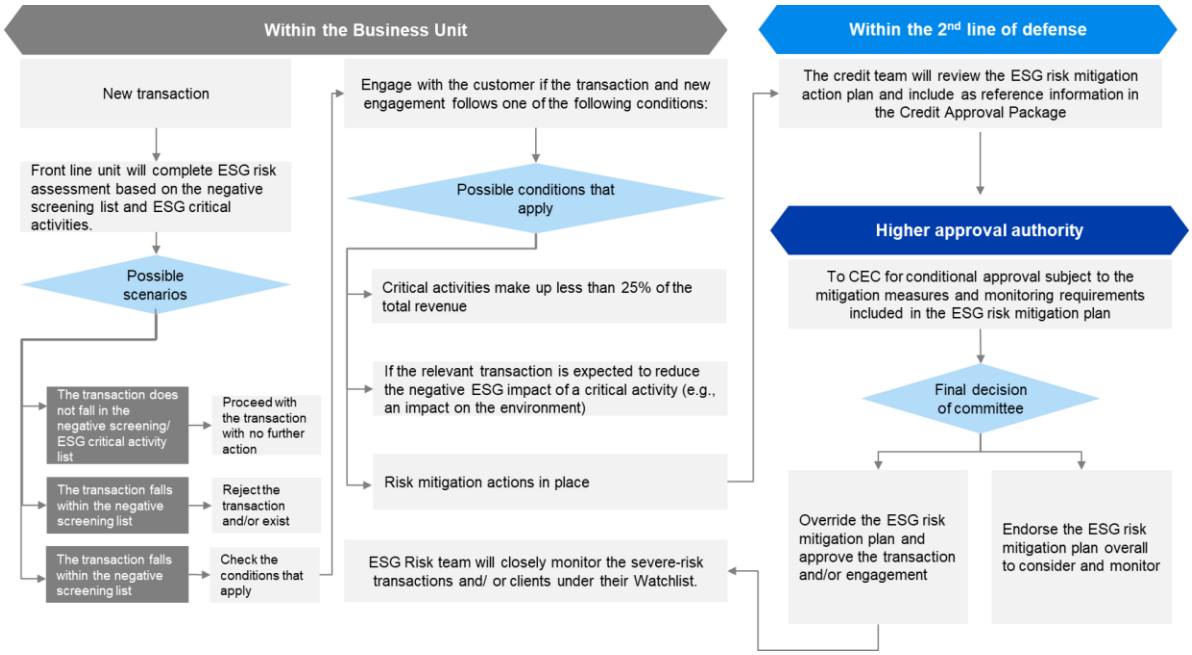

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Figure 7.3: ESG risk assessment process for periodic credit reviews for high ESG risk sector clients and/or governmental entities

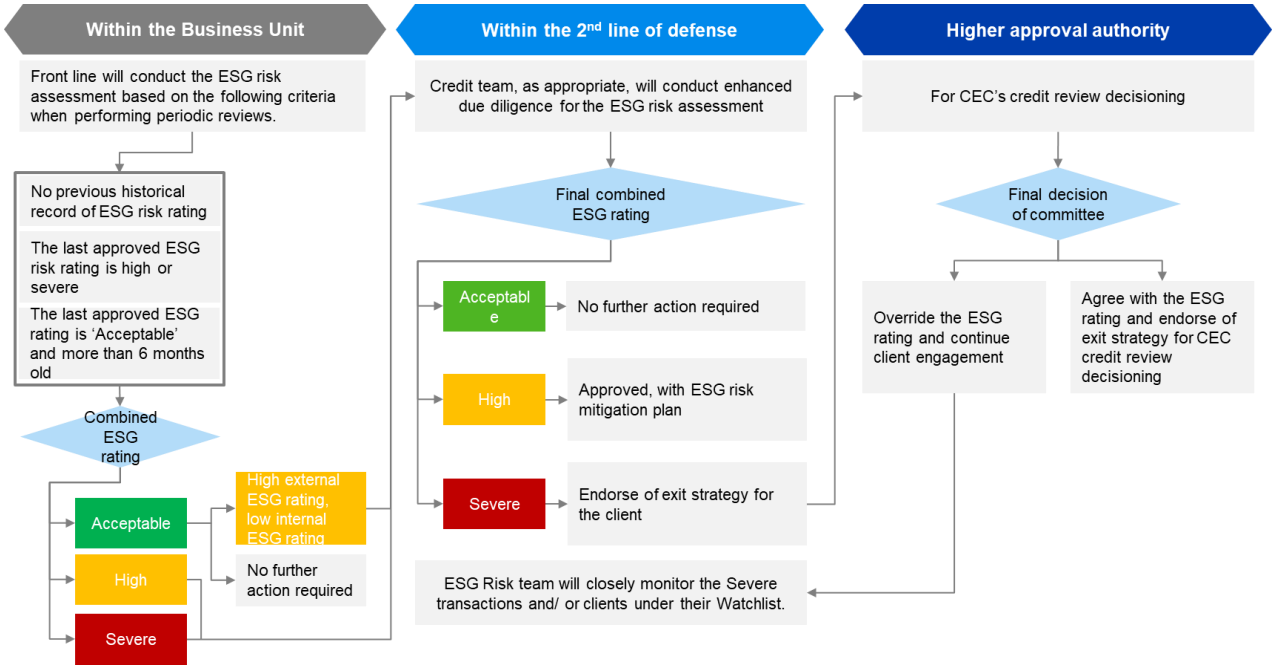

Figure 7.4: ESG risk assessment process for periodic reviews of non-borrowing clients for high ESG risk sector clients and/or governmental entities

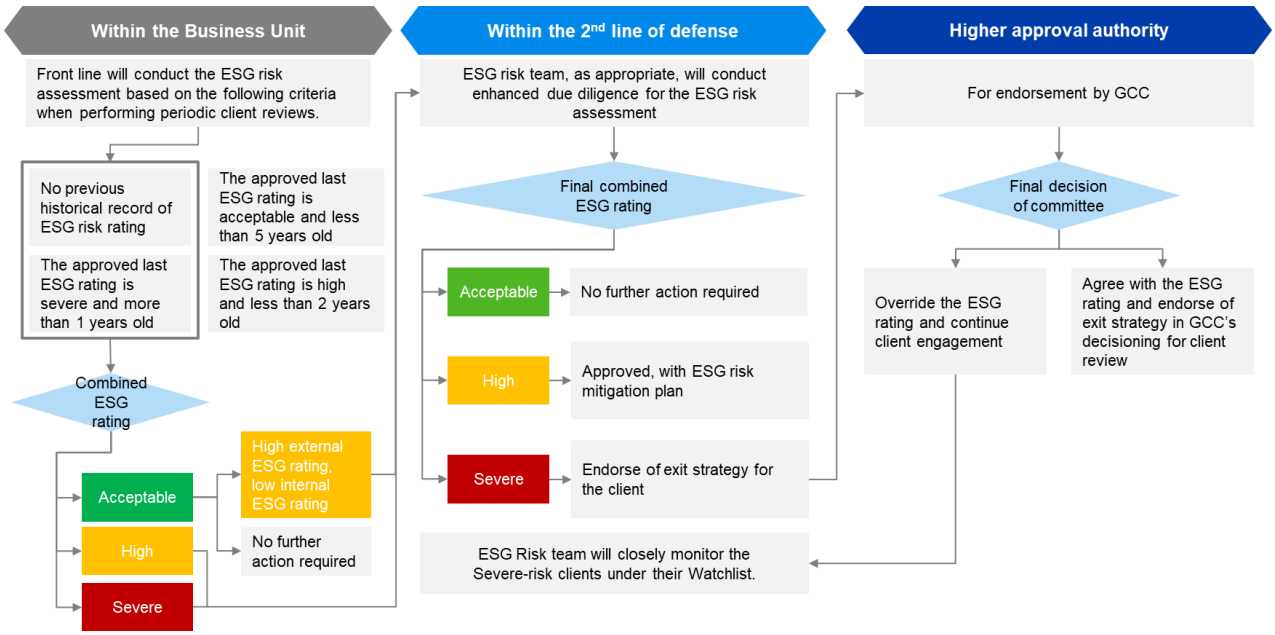

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Figure 7.5: ESG risk assessment process for event-driven reviews

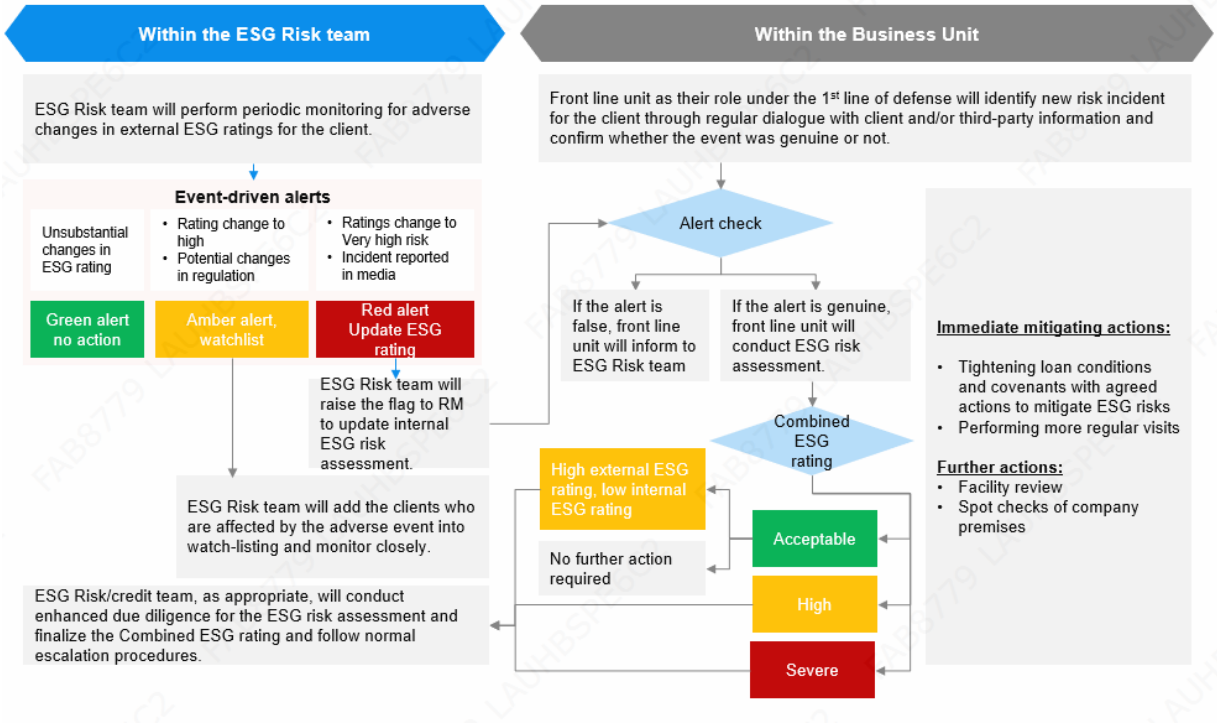
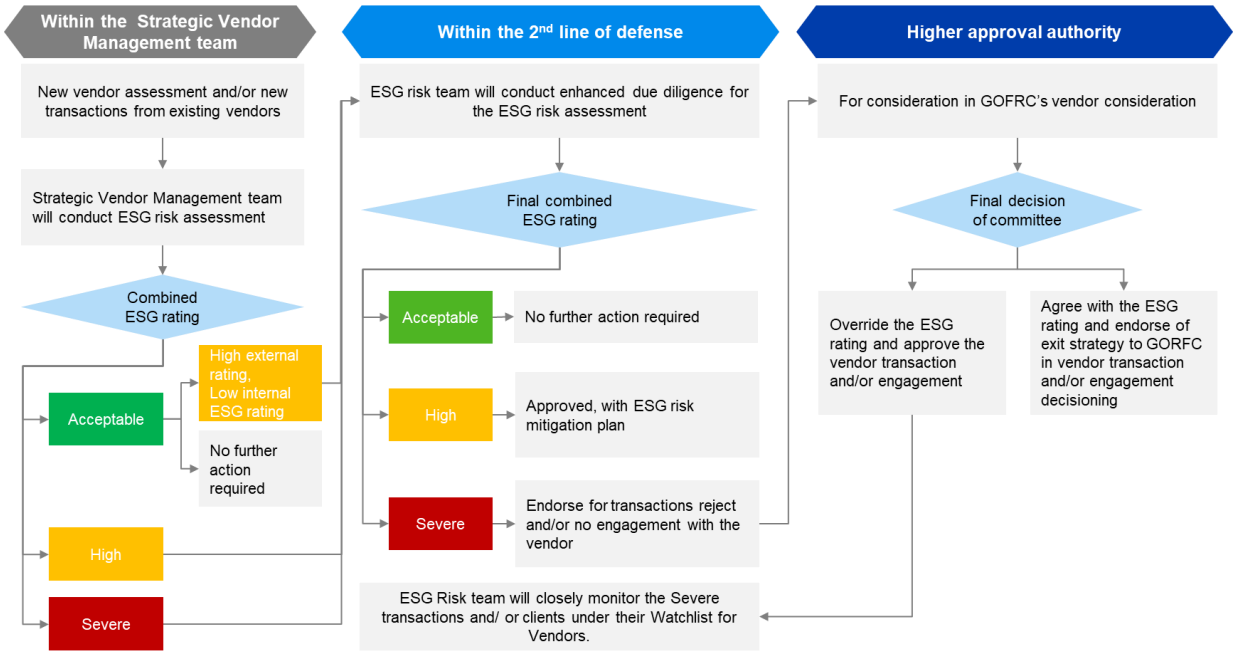


Figure 7.6: ESG risk assessment process for vendors



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7.6 Annexure VI: Stress testing approach

Scenario library.xlsx

7.7 Annexure VII: Mitigation actions

Table 7. 8: Examples of ESG Risk Mitigation actions

Sector	Actions
Oil and Gas	Strategy and business plan to reduce Scope 1 emission within 1 year and disclose performance against those targets in 2 years
	Develop environmental management policy and/or get certified for environmental management system ISO 14001
	Material investment in R&D expenses to reduce emissions and/or in renewable energy, and revenue share from renewable energy within 1 year
Coal	Commitment to invest into renewable energy for reducing electricity costs in the coal mines
	Any action plans to establish ESG activities and reporting
Transportation	Establish strategy and business plan to cut GHG pollution per km from fuel combustion within 1 year and disclose performance against those targets in 2 years' time
	Material investment in R&D expenses to improve fuel efficiency in vehicles and use of renewable fuels
Construction	Material investment on use of building materials with lower embodied carbon and sourcing materials within 2 years
	Material investment in changing building standards, zoning, and planning controls to anticipate climate risks within 1 year
	Certificate of ISO 45000 (H&S) management system and a clear target to mitigate workplace risks and incidents within 2 years
Mining and quarrying (excluding coal)	Establish strategy and business plan to cut GHG emissions released from mining and quarrying and disclose performance against those targets annually
	Material investment on use of building materials with lower gas emissions and provide capital expenditure targets to reduce costs and improve technology within 2 years
Chemicals - Commodity	Establish strategy and business plans for key social risks of chemical companies such as, demographics, safety management and influence of consumer behavior within 1 year
	Set CO2-neutral growth targets and provide investment on the production process to limit carbon dioxide emissions within 2 years
	Investment in training of employees on health, safety and operations that involve handling dangerous products and complex chemical reactions within 1 year

Activities	Actions
Community engagement	Investment in relevant community engagement events within 1 year that aim to contribute to the overall aims of the engagement process
	A community engagement action plan within 1 year to raise the levels and quality of participation at the local level and encourage local communities to address issues and concerns through the community planning process
Business ethics	Provide a code of business conduct and ethics for employees and senior management to abide by within 1 year
Governance	Public disclosure of board structure, corporate governance policy, corporate ESG reports, environmental targets, and code of conduct

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