PAObank

PAO BANK LIMITED

CLIMATE-RELATED DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2023

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1. About This Report

This report provides an overview of PAO Bank Limited ("the Bank") climate-related management and performance in 2023. The content covers our climate-related financial disclosures, including governance, strategy, risk management, and metrics and targets.

Unless otherwise stated, the data and information in this report covers the period from 1 January 2023 to 31 December 2023.

2. Governance

2.1 Climate Risk Management Governance Structure

The Board takes overall responsibility for overseeing the development and implementation of the Bank’s climate risk strategy. The Board Risk Management Committee ("BRMC") is delegated by the Board to perform its supervision duties regarding the implementation of the Bank's climate risk strategy. The BRMC holds its meeting every quarter to steer climate risk related matters.

The Risk Management Committee ("RMC"), chaired by the Chief Risk Officer ("CRO"), is responsible for implementing the Bank's climate risk strategy and leading incorporation of climate risk into our risk management. Through this monthly forum, senior management proactively manage climate-related risk by establishing climate risk management policies and risk appetite, regular reviewing our risk triggers and limits, and monitoring our climate risk profile.

2.2 Key issues and initiatives

We have integrated climate change issues into the current governance structure. Any key issues and initiatives in climate-related governance are identified and discussed with the Board. For example, in 2023, the Board has reviewed the Bank’s climate risk management framework and the Bank’s risk appetite statement (“RAS”) which incorporates climate-related risk consideration and reflect the Bank’s risk appetite towards exposure related to high-emission sectors. The Bank will continue to enhance its climate risk management framework in response to changes in market and regulatory environment.

3. Strategy

3.1 Risk identification process

Recognizing that the impacts of climate change are likely to be long term, we have defined three time horizons – short, medium and long term[1] - in the process of risk identification. Climate change could pose risks to the Bank as well as our clients through transition risk and physical risk.

- Transition risk: The risks associated with industrial transformation in a low carbon society. For example, regulations on some high carbon emission industries may have material impacts on their business. Market sentiments will also change, with investors preferring industries that are low-carbon and environmentally friendly. All of these transformations pose transition risks on the customers and thus the Bank.
- Physical risk: As climate change intensifies, extreme weather events are occurring more frequently (e.g., typhoons, heat waves, mountain fires, etc.). These may have a significant impact on the Bank's own operations, the value of its customers' collateral, etc.

Climate-related risk	Risk sub-category	Potential impact	Impacted time horizon
Transition Risk	Policy and Legal	Enhanced regulations and supervision of climate-related risks impose greater obligations on the Bank's emission reduction target and information disclosure, leading to increased operational costs and legal risk.	Short-Term to Long-Term
	Technology	Technological advancement leads to replacement of traditional high emission industries by new low-carbon industries, which may affect the Bank's business strategy and risks exposure. Also, additional investment cost may incur to replace existing products with lower emission options.	Medium-Term to Long-Term
	Market	Climate changes may affect market landscape in various ways, such as changes in customer behaviour, uncertainty in market signals and increased cost of raw materials.	Short-Term to Long-Term
	Reputation	Reputational risk is tied to changing customer or community perceptions of the Bank's contribution to or detraction from the transition to a lower-carbon economy. Investors and the public attach greater importance to the topic of climate transition and take the Bank's climate performance into consideration when making investment and business decision.	Short-Term to Long-Term

[1] Time frame: short term (0-1 years), medium term (2-5 years), long term (6-10 years).

Climate-related risk	Risk sub-category	Potential impact	Impacted time horizon
Physical Risk	Acute	Extreme weather events (e.g. typhoon, torrential rains and wildfires) may lead to disruption of supply chains, damage to facilities (such as telecommunication and computer system failures), and business disruptions to employees and/or suppliers.	Short-Term to Long-Term
	Chronic	Longer-term shifts in weather patterns (e.g. rising average temperatures and sea level) could result in an increased operational costs and potential financial loss.	Medium-Term to Long-Term

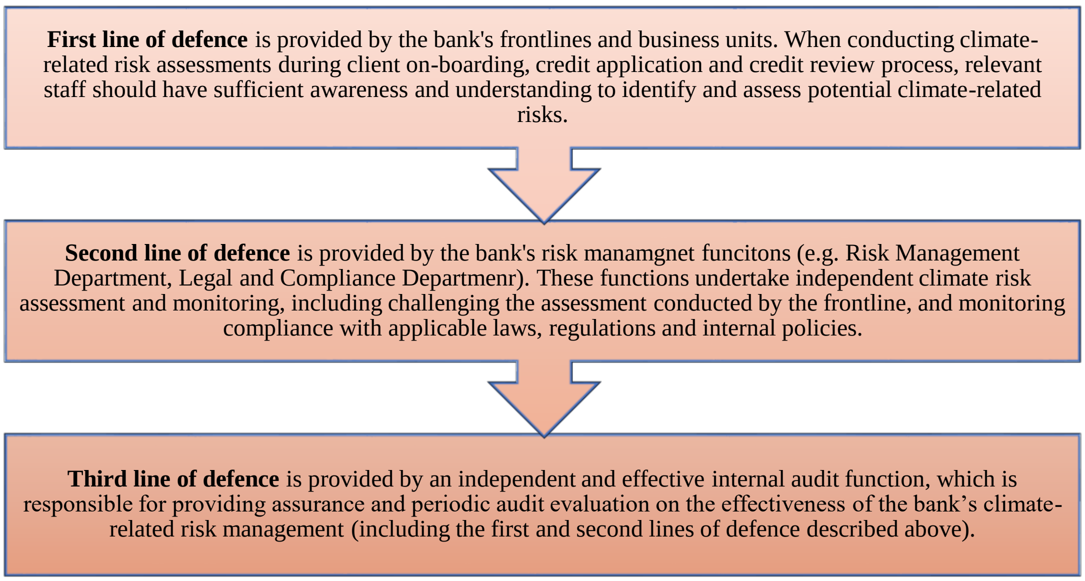
3.2 Scenario analysis

To properly manage climate-related risk and assess its potential impact, the Bank recognizes the importance of understanding how climate risk could be transmitted to traditional risk types that are material to the Bank's financial and operational performance. We take into consideration the Bank's unique business model, which focuses on lending to small to medium-size enterprise via digital channels. We therefore identified credit risk being a major risk impacted by climate changes.

Stress testing and scenario analysis are key initiatives in our efforts to assess and quantify climate risk. In 2022, we have developed our stress testing and scenario analysis models and related workflows, and analyzed the impact of physical risk and transition risk to our existing types of risk exposure. We also performed stress testing and scenario analysis on asset portfolios with high climate risk sensitivity to assess the impact of climate scenarios on banks' earnings and capital levels, and incorporated conventional risk analysis tools where appropriate. The methodology and assumptions we adopt are in line with the requirements of module GS-1 "Climate Risk Management" and IC-5 "Stress Testing" of the Hong Kong Monetary Authority's Supervisory Policy Manual. For transition risk, our scenario analysis has taken reference from the representative scenarios developed by the Network of Central Banks and Supervisors for Greening the Financial System ("NGFS"). For physical risk analysis, reference was made to scenarios published by Intergovernmental Panel on Climate Changes ("IPCC"). Our latest assessment concluded that the climate risk impact remains insignificant to the Bank's risk exposure.

4. Risk Management

The financial industry is investing significant resources in testing methodologies for how to best address climate risks, yet accurate data and relevant tools remain inadequate in the near term. Appropriate corporate disclosure supported by common definitions and standards, plays an important role in improving the data necessary for the industry to appropriately quantify and manage climate risk.



We have tailored our approach by integrating climate considerations into the overall risk management routines. The risk appetite has also been reviewed to reflect the risks from climate change. Moreover, we have set out control and mitigation measure we intend to take to support our climate risk management.

4.1 Integrating climate risk into overall risk management

We have identified transmission pathways from climate risk to traditional financial risks, based on which we have taken steps to embed the consideration of climate-related risks throughout our risk management framework to ensure comprehensive consideration across our business activities.

4.1.1 Three lines of defence

Our risk governance framework provides clear oversight and ownership of management of climate-related risk across three lines of defence. The diagram below is the roles and responsibilities of managing climate-related risks allocated among three lines of defence.

4.1.2 Climate risk management

The Climate Risk Management Policy was established to provide an overarching framework for managing climate-related risks and opportunities. The policy is structured to meet our ambitions relating to climate change and expectations from regulations, investors, and the public. As a core element to our climate risk management framework, the Board has approved the Bank's risk appetite statement that is embedded with climate-related considerations based on management's risk assessment and stress testing results. Quantitative metrics, i.e. high emitting sector industry limits, were adopted to monitor and limit exposures on two carbon intensive sectors, i.e. Electrical & Electronics Engineering and Construction. The Bank's Risk Management Department is responsible for regular monitoring of risk limits and escalate climate-related issue to the RMC. From time to time, it performs climate-related risks assessments and proposes adjustment to the risk appetite statement if and where needed. The RMC serves as the management level committee to oversee the implementation of the Bank's climate risk appetite and its ongoing compliance. The Board and its delegate, BRMC, are ultimately responsible for reviewing and approving the RAS to ensure its relevance and consistency with the Bank's climate strategy.

Based on the climate risk management framework, we have also embedded climate-related considerations into relevant business and risk policies (e.g., credit assessment documents) to ensure necessary guidance is provided to our colleagues to support their client engagement.

4.2 Measures to control and mitigate climate-related risk

The Bank attaches great importance to improve its ability to identify climate risks and integrate them into its risk management and broader business strategy. Several initiatives were taken to enhance climate-related risk reporting and monitoring, for example, by establishing a bank-wide emission data collection template and providing training to employees. We will make continuous effort to strengthen our climate risk management and adopt risk mitigation measures when necessary.

5. Metrics and Targets

5.1 Overview

Recognizing the urgency and significance of climate issues, the Bank is currently in progress to develop qualitative and quantitative metrics and targets to support its climate risk management and strategy implementation. We identified, collected and disclosed our Green House Gas (“GHG”) emission in the year of 2023. By increasing transparency of our GHG emissions, we are providing our stakeholders with a better understanding of our carbon footprint and demonstrating our commitment to reducing our impact on the environment. It also enables us to identify areas for improvement and set targets to reduce our carbon footprint.

To ensure the accuracy of our GHG emissions reporting, we benchmarked global standards for GHG calculation and adopted TCFD recommendation to calculate our Scope 1 and 2 emissions. Due to its virtual bank business model, the Bank currently incurred a minimal amount of scope 1 emission in its operation. We identified the major source of GHG emission being purchased electricity reported in the scope 2 indirect emission as below:

	Category	Total emission in the year of 2023
Scope II (Indirect Emissions)	Purchased Electricity	23.02 (in tons of CO2e)

We have also established robust data collection and processing methods to ensure the completeness and accuracy of our emissions data. The articulation between our GHG emissions and the standards used to calculate them, as well as our data collection and processing methods, ensures that our emissions reporting is transparent, accurate, and reliable. This transparency allows us to set targets to reduce our emissions, manage climate-related risks, and support the transition to a low-carbon economy.