

Towards a Greener Financial System

Financial sector demonstrated increased commitment and responses in building climate resilience, and in supporting transition and green efforts of customers. Specific focus was accorded to developing practical support for SMEs to build climate resilience and capacity to transition.

Introduction

In 2023, BNM continued its efforts to put in place the key pillars that will enhance climate resilience and manage climate-related risks within the financial sector. Our efforts aim to support financial institutions and the real sector transition to a greener economy. We remain committed to ensuring that our initiatives and that of the financial sector are aligned to national policies and strategies. Within BNM, we progressed further in greening our own operations. This was supported by continuous efforts to build internal capability and expertise.

Since we began our climate journey in 2019, financial institutions have shown encouraging progress in catalysing the transition to a greener economy. Frameworks and tools that have been developed are being progressively put into practice. These include the transition taxonomy for classifying economic activities in alignment with climate-related outcomes, implementation of regulatory standards and clearer supervisory expectations on managing climate risks. Following issuance of the climate risk management standards¹ at end-2022, we actively engaged with the industry to assess their readiness in operationalising the requirements. Financial institutions have also advanced preparations to comply with the annual climate-related

disclosure standards² which will take effect from the financial year beginning 2024. In supporting meaningful disclosures with credible data, efforts were intensified to improve availability of and access to crucial data needs of the industry. This covers data on vehicle emissions, floods, and renewable and non-renewable energy components. Financial institutions have committed more than RM240 billion in financing for environment, social and governance (ESG) initiatives up to 2027. This is an increase of about RM130 billion as compared to the previous year. We expect more to be allocated in the coming years in line with greater policy clarity on sectoral transition pathways. Overall, financial institutions are including climate considerations into their risk management, strategies, internal operations, business decisions and product offerings (Diagram 1).

Climate Risk Considerations Embedded Across BNM

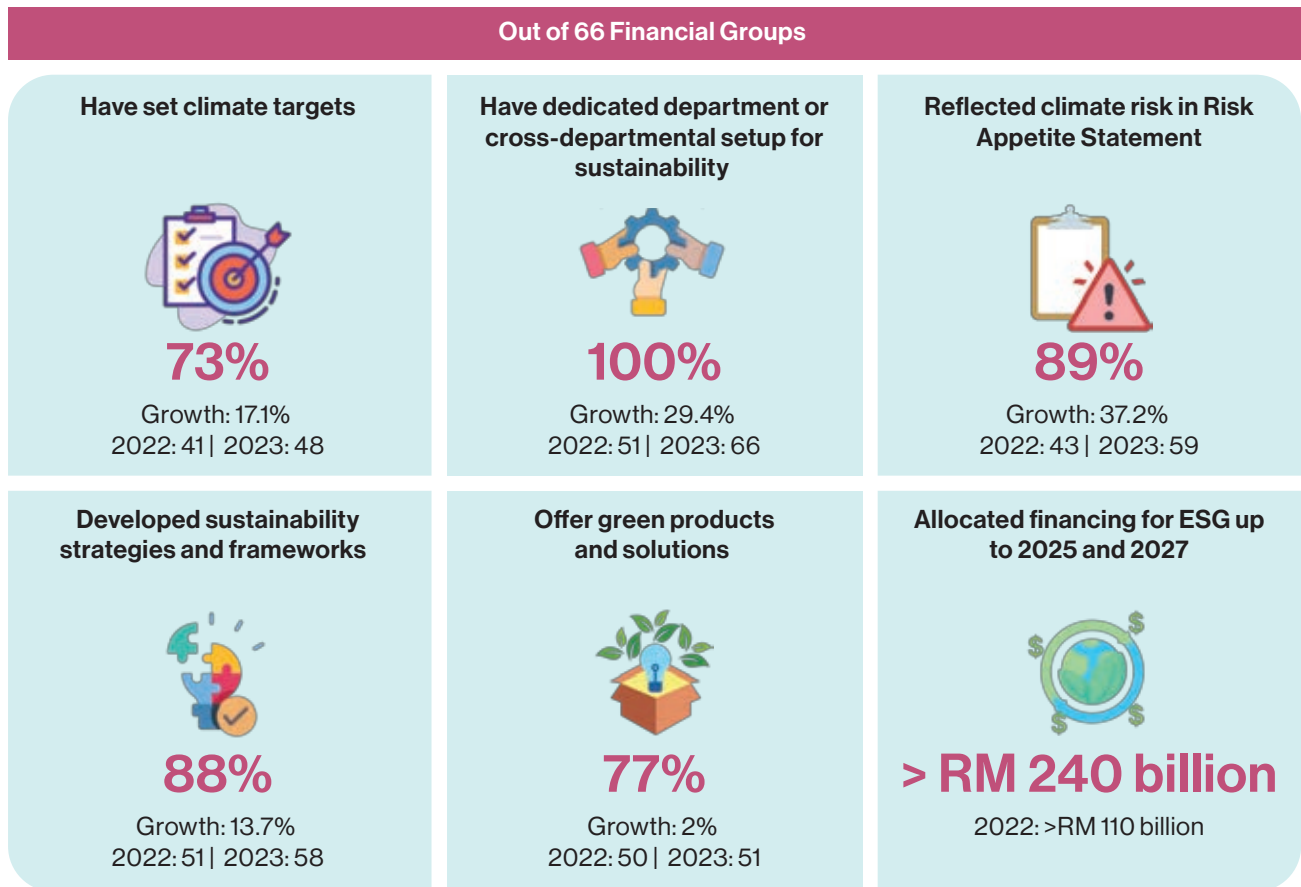
BNM acknowledges climate risk as one of the key challenges that it needs to address in pursuing its mandates. This is now reflected in our enterprise risk appetite statement. Our board and senior management provide direction on BNM's key focus areas and priorities to address climate-related risks within its mandates. These include policy development, research and analysis, advocacy as advisor to the Government, regional collaboration and adoption of sustainability practices within our own operations. Regular updates are provided to the board and senior management on the progress of climate-related initiatives across BNM and the financial sector.

The Sustainability Unit serves as a dedicated function that coordinates and drives BNM's climate initiatives. The Unit works closely with departments within BNM in delivering coordinated climate outcomes. Climate considerations are increasingly embedded across all aspects of our work and operations as knowledge and understanding improve.

¹ Policy document on Climate Risk Management and Scenario Analysis, CRMSA.

² The climate-related disclosures, aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), are to be published together with annual financial reports.

Diagram 1: Progress Observed in the Financial Industry in 2023



Note: 66 financial groups comprise banks (conventional and Islamic), investment banks, development financial institutions, insurance and takaful operators.

Source: Bank Negara Malaysia

Steady Progress in Advancing Climate Agenda

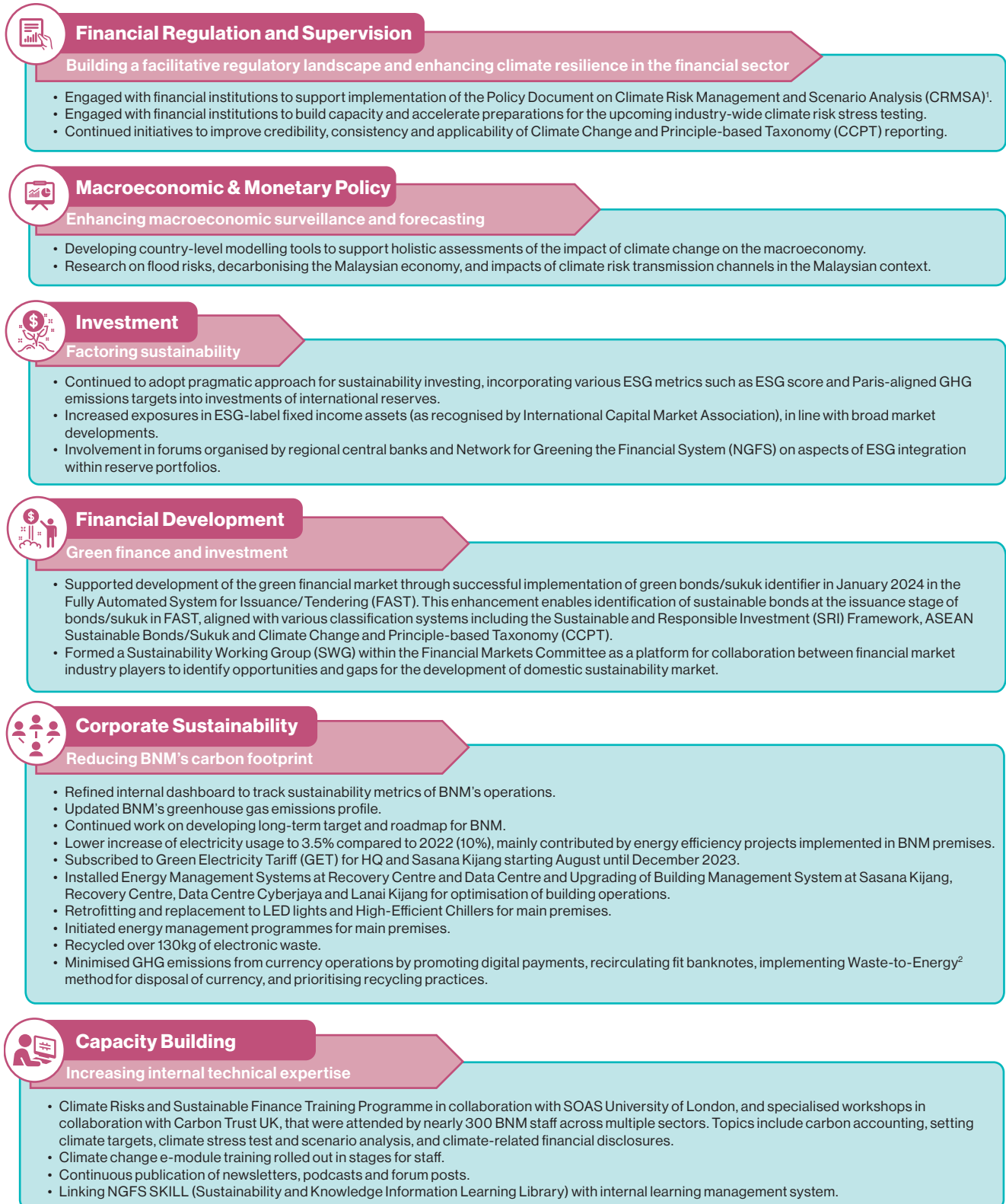
In 2023, BNM continued to make steady progress in integrating climate-related risk considerations in our core functions (Diagram 2). Our priorities centred on preparing financial institutions for upcoming regulatory initiatives such as the industry-wide climate risk stress testing. For this, we periodically engaged financial institutions to provide clarity on our expectations. We leveraged such engagements to be better informed of challenges and issues facing the industry. We also continued to deepen our understanding and approaches to assess the impact from climate-related events on our economy and financial sector. An example is the research we conducted together with the World Bank to analyse how businesses can be impacted by floods, and role of the financial sector in supporting businesses to manage flood risks.³

Internally, we ramped up efforts to better manage emissions arising from our operations. In 2023, we subscribed to the Green Electricity Tariff (GET) for our main premises which offset our scope 2⁴ electricity emissions by about 35% between August to December. This is done alongside an energy management programme to directly reduce our emissions. During the year, we further enhanced the way we approach and measure our emissions. We refined our internal dashboard that tracks sustainability metrics, such as for our electricity use, water use, and plastic waste. We also intensified work on developing a more robust emission measurement, monitoring as well as reporting framework. This is part of our current efforts to develop a roadmap for our physical operations to guide our actions towards achieving our climate goals.

³ Key findings are published in the report entitled 'Managing Flood Risks: Leveraging Finance for Business Resilience in Malaysia' and featured in the box article on (Flood and Finance: Building Resilience of Malaysian Businesses) in BNM's Financial Stability Report 2H 2023.

⁴ Scope 2 emissions are indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling.

Diagram 2: Progress and Outcomes of BNM's Climate Initiatives in 2023



¹ Details on BNM's assessment of the CRMSA implementation plans submitted by financial institutions are in the box article on 'Climate Risk Management and Scenario Analysis' in BNM's Financial Stability Report 2H2023.

² Waste-to-Energy (WTE) method converts solid waste into usable forms of energy, such as heat and electricity. Details on WTE and issuance of fit banknotes are in the Chapter 1.6 on Issuing Currency of Bank Negara Malaysia's Annual Report 2023.

Source: Bank Negara Malaysia

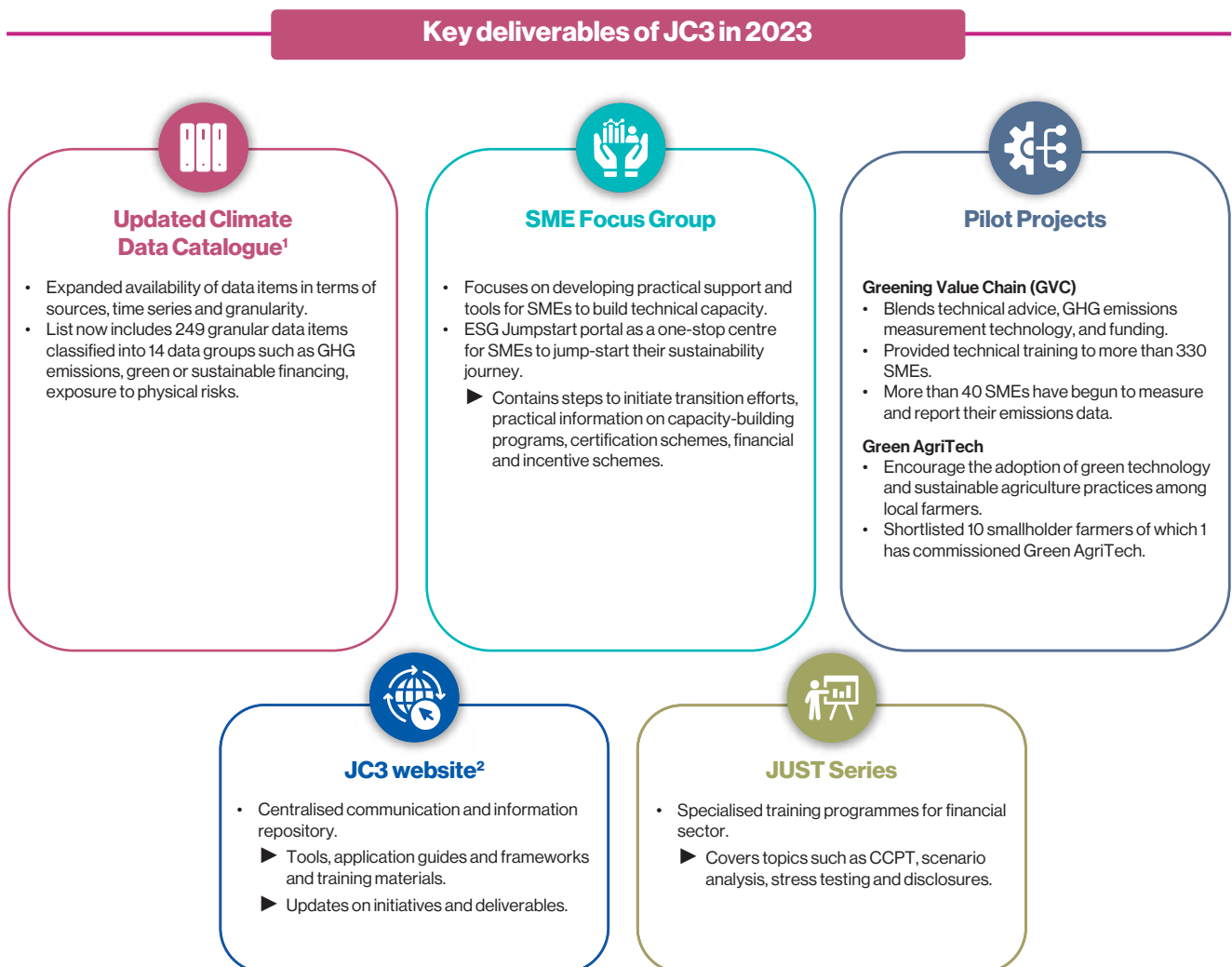
Leveraging Synergies through the Joint Committee on Climate Change (JC3)

The JC3 continues to serve as a key focal point in supporting the financial sector's response to and preparedness for climate change.

In 2023, the JC3 continued to focus on credible implementation of the Climate Change and Principle-based Taxonomy (CCPT). The JC3 introduced a standard due diligence questionnaire to facilitate financial institutions in obtaining information from their customers for appropriate assessment and classifications.

In supporting transition efforts, the JC3 served as the platform to coordinate initiatives between BNM, Securities Commission Malaysia (SC), the industry and relevant Government ministries and agencies to develop and implement pilot projects to scale up climate finance. This includes piloting public-private partnerships to seed transition and adaptation financing solutions for small and medium enterprises (SMEs) to green their operations and build climate resilience. The Greening Value Chain (GVC) and Green AgriTech pilot projects were successfully implemented and the JC3 is in the midst of embarking on a new pilot project to green industrial parks. Improving access to financing for SMEs was also actively pursued with relevant organisations such as development financial institutions and Credit Guarantee Corporation Malaysia Berhad (CGC).

Diagram 3: Key deliverables of JC3 in 2023



¹ <https://www.jc3malaysia.com/data-catalogue>

² <https://www.jc3malaysia.com/>

Source: Bank Negara Malaysia

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CGC in partnership with 18 participating banks are now offering a RM1 billion portfolio guarantee scheme for ESG financing for SMEs.

Building technical expertise in climate risk and sustainability remains an important agenda for JC3. The JC3 led capacity building efforts for the industry on key technical areas covering topics such as social sustainability, transition plans and nature-related disclosures. The JC3 also increased engagements with the wider industry via the JC3 Outreach Sessions conducted in June and November. The sessions aim to create more awareness on JC3 and its initiatives, as well as share key updates on domestic and global climate-related initiatives. The biennial JC3 Journey to Zero Conference was held in October, focusing on practical applications of climate and nature finance. The Conference attracted more than 650 physical attendees and more than 4,000 virtual attendees across the three days.



Governor Abdul Rasheed Ghaffour delivering keynote remarks at JC3 Journey to Zero Conference.



Deputy Governor Jessica Chew as a panellist at the JC3 Journey to Zero Conference.

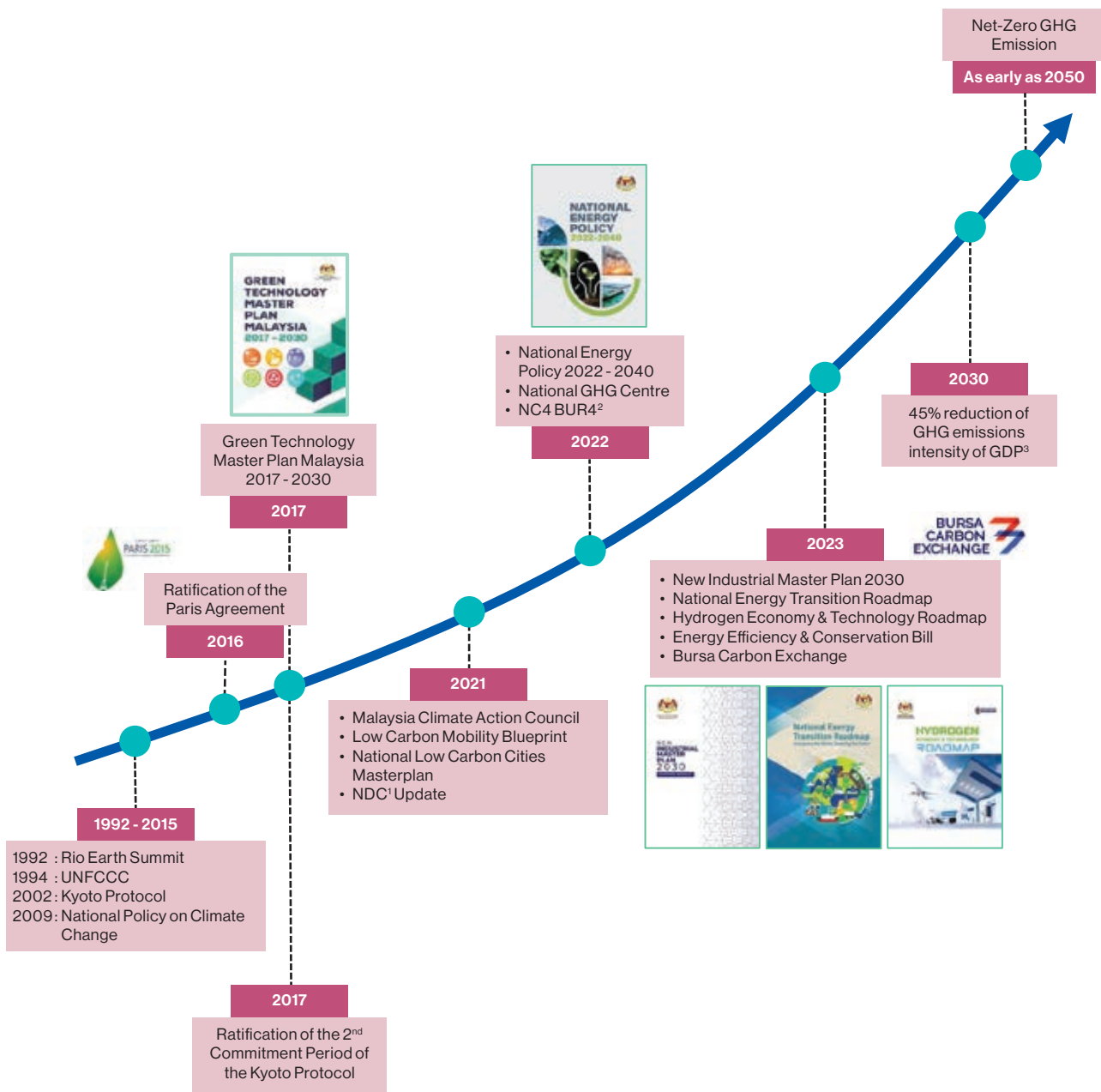
The JC3 also works in partnership with the Value-Based Intermediation Community of Practitioners (VBI CoP). This has led to the issuance of Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) sectoral guides in 2021 and 2022. Following consultations with the JC3, the VBI CoP is currently finalising the VBIAF sectoral guides on agriculture, forestry and fishing, waste management, road transportation, mining and quarrying. These are in addition to the sectoral guides on oil and gas, manufacturing, and construction and infrastructure issued in 2022, as well as on palm oil, renewable energy and energy efficiency issued in 2021. The sectoral guides complement the CCPT by providing sector or transaction level guidance.

Playing Our Part in the 'Whole-of-Nation' Response to Climate

We continued to forge closer ties with many Government ministries and agencies in 2023. This helped to inform national policy while ensuring alignment in the financial sector's climate response.

Policy responses at the national level gained traction during the year, providing critical policy clarity for businesses and the financial sector. Key policies include the National Energy Transition Roadmap (NETR), the Hydrogen Economy and Technology Roadmap (HETR) and New Industrial Masterplan (NIMP). For many of these national policies, BNM was involved to provide financial sector perspectives. BNM is a member of steering committees for the NETR and NIMP, as well as the National Steering Committee on Climate Change, and National OGSE Sustainability Roadmap (NOS-R). BNM is also an observer in the Electric Vehicle Taskforce.

Diagram 4: Malaysia's Decarbonisation Journey



¹ NDC = Nationally Determined Contribution
² NC4 BUR4 = 4th National Communication & 4th Biennial Update Report
³ Achievement of Malaysia's Emissions Reduction Commitments under the NDC

Source: Bank Negara Malaysia

Increasing Awareness through Communication

We continued to actively share our initiatives and views on the important role that the financial sector plays in facilitating an orderly and just economic transition.

The JC3 and BNM were part of Malaysia's delegation at the 28th United Nations Climate Change Conference (COP28) in November to December 2023 in Dubai, United Arab Emirates. We explored opportunities for developing potential partnerships to scale up transition finance in Malaysia. We spoke in several sessions,

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covering topics such as climate finance, nature and biodiversity, and energy transition. We also shared our regulatory approach in strengthening financial institutions' readiness to build climate resilience and to

support transition. These efforts aimed to showcase Malaysia's transition and green initiatives while also generating interest for partnerships with domestic financial institutions.



Deputy Governor Jessica Chew delivering keynote address at the Institute of International Finance-Maybank Transition Finance Workshop.



Assistant Governor Dr. Norhana Endut delivering keynote address at the Nature, Finance and the Macroeconomy Conference.



Governor Abdul Rasheed Ghaffour offering remarks at Malaysia's Climate Finance Day at COP28.



Madelena Mohamed (Sustainability Director) as speaker at the Leaders Dialogue on Accelerating SMEs' Resilience in A World of Growing Climate Risks at the Italian Pavilion at COP28.

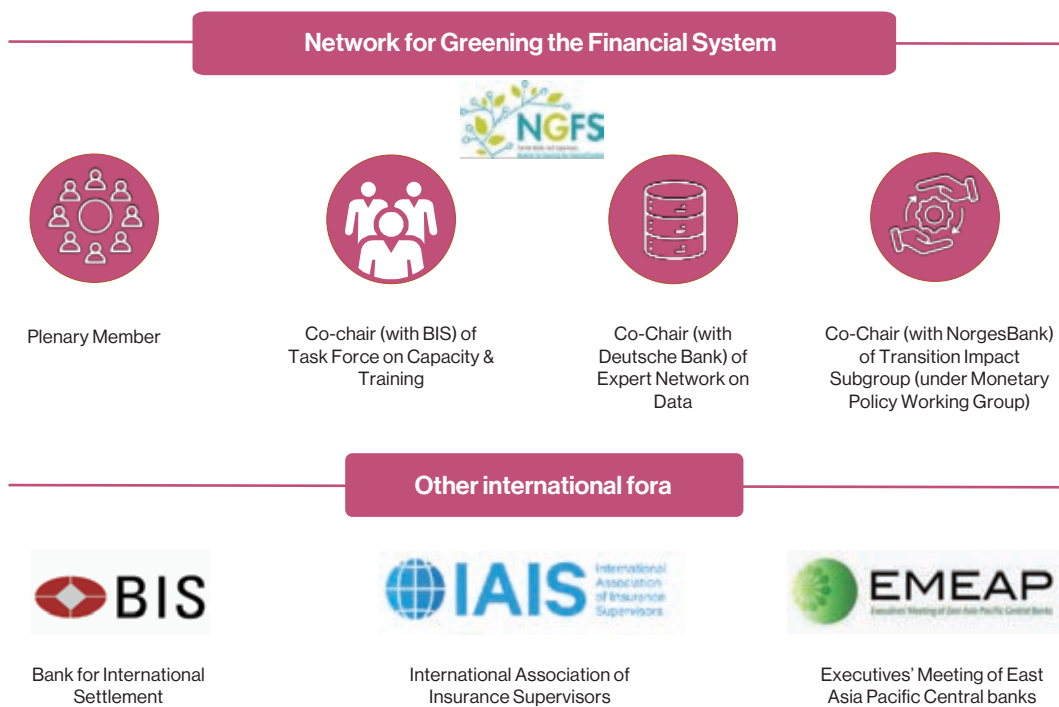
Contributing to Regional and International Thought Leadership

BNM continues to advocate for global collective action to improve climate equity and avoid a disorderly transition. This is done through our participation in international bodies such as the Central Banks and Supervisors Network for Greening the Financial System (NGFS) and other fora. In these platforms, we provide an important perspective on transition challenges for emerging market economies (EMEs). Some of the key challenges include the large financial investments, knowledge, and technological advancements required to tackle the unequal effects of climate change. Greater appreciation of issues facing EMEs has contributed towards bridging gaps in the work of the international

bodies and fora to support a more credible global response to the climate challenge.

The ASEAN Taxonomy Board, of which BNM is a founding member, published an updated version of the ASEAN Taxonomy for Sustainable Finance Version 2⁵ in February 2024. The updated version sets out the final set of Technical Screening Criteria (TSC) for electricity, gas, steam and air conditioning supply sector (energy sector). During the year, BNM led the development of thresholds for the construction and real estate focus sector (Diagram 6). This builds on earlier experience in developing the TSC for the energy sector. The release of the TSC for the construction and real estate is scheduled in the first quarter of 2024, alongside the TSC for transport and storage.

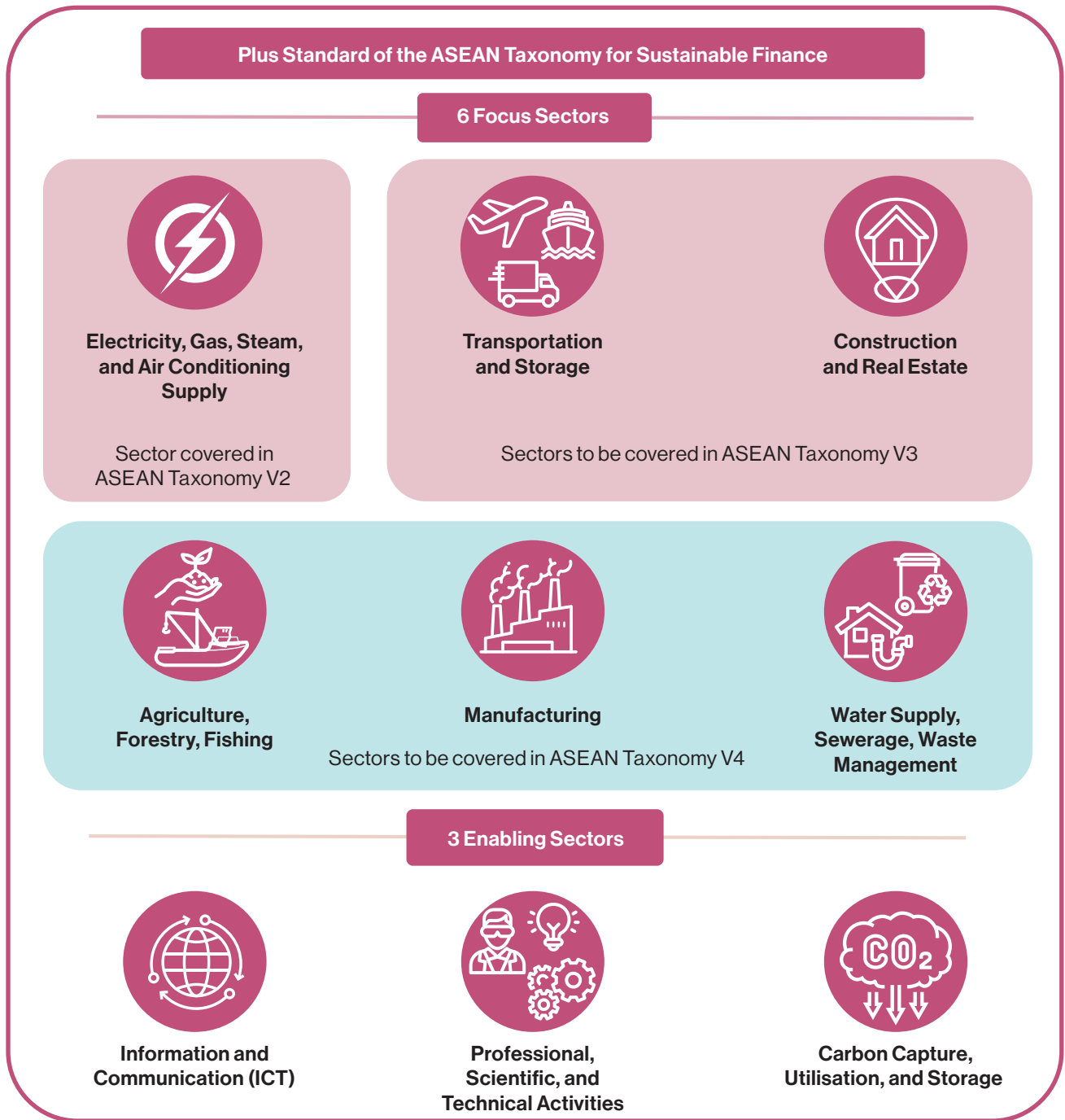
Diagram 5: Bank Negara Malaysia's Participation in NGFS and Other International Fora



Source: Bank Negara Malaysia

⁵ The ASEAN Taxonomy for Sustainable Finance serves as a guide for businesses and investors in pursuing green and transition activities. In addition, it supports the flow of inclusive transition finance to the region. It adopts a multi-tiered approach comprising the Foundation Framework and the Plus Standard to cater to the diversity of ASEAN Members States. Further information can be found via <https://asean.org/book/asean-taxonomy-for-sustainable-finance/>.

Diagram 6: Plus Standard and Focus Sectors of the ASEAN Taxonomy for Sustainable Finance



Source: Bank Negara Malaysia

Addressing Nature-related Financial Risks

Nature-related risks pose a significant threat to the economy and society. Climate- and nature-related risks are interconnected. Climate change is one of the five primary drivers⁶ of biodiversity loss, leading to weaker ecosystems in terms of structure, functioning, and resilience. At the same time, forests, mangroves, and peatlands are natural carbon sinks, capturing and storing carbon dioxide while also providing protection from extreme weather events.

As with climate change, nature-related risks can lead to financial and economic losses. Nature-related risks can also worsen the effects of climate change. Since 2022, BNM has begun to look at nature-related risks. To better understand the relationship between the financial sector and nature, BNM together with the World Bank conducted a joint study⁷ to assess the financial sector's exposures to nature. The study also looked at the financial sector's exposures to businesses that are reliant on nature. The report contributes to BNM's approach in managing climate and nature-related risks and pursuing opportunities related to climate and nature. This includes the untapped potential of nature-based solutions (NbS) in addressing climate change and environmental-related issues in Malaysia.⁸ Given the close interactions between climate- and nature-related risks, it is crucial for financial institutions to leverage work to deepen their understanding, knowledge and responses to climate change to also cover nature-related aspects. This will expedite financial institutions' responses in building their resilience against environmental issues alongside climate change.

Taking the earlier work done with the World Bank further, BNM announced its collaboration with the Taskforce on Nature-related Financial Disclosures (TNFD) and

the World Bank to develop a financial risks assessment guide for nature for financial institutions at COP28. This will leverage the LEAP (Locate, Evaluate, Assess, Prepare) framework by the TNFD. This can help financial institutions to also explore scaling up private capital mobilisation for nature-based solutions. Working with the World Bank, BNM will also be commencing a study to explore nature-based solutions and financing options most suited for Malaysia.

Going Forward

Malaysia is at a turning point in its climate journey. It is important to chart the right course of action to meet its net zero target as early as 2050. For the financial sector, it is time to shift gears to the implementation phase, with key building blocks, national policies and roadmaps that are now in place. The financial sector has a key role to play in facilitating the execution of national policies and roadmaps by developing innovative products and solutions to channel finance to climate friendly activities or activities that support green transition. Blended finance mechanisms are an avenue to fund high risk transition and adaptation activities using both public and private sector monies.

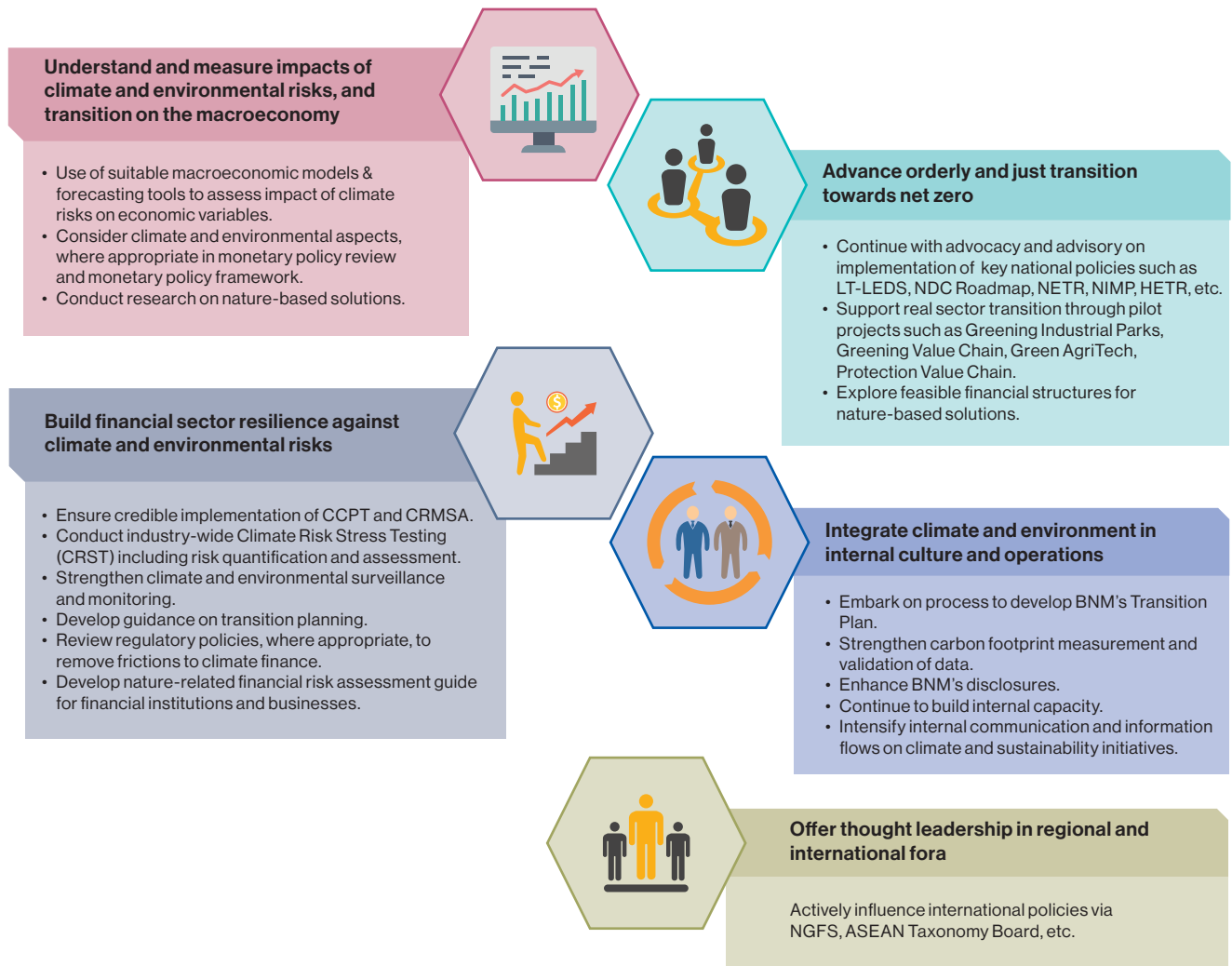
For BNM, the focus remains on ensuring that the financial sector's response to climate challenge is compatible with monetary and financial stability, economic growth and inclusion outcomes. This includes refining our regulatory and supervisory approach and extending our scope to include nature-related financial risks. We aim to provide a policy environment that is facilitative for the industry to advance financial innovations and explore novel financial structures to meet the significant financing needs for climate risk mitigation and adaptation. We will also continue to advance our research work and strengthen internal competence and awareness to build a green culture within our own operations.

⁶ Land use changes, overexploitation of natural resources, climate change, pollution, and invasive species.

⁷ Findings are published in the report on 'An Exploration on Nature-related Financial Risk' in March 2022.

⁸ More information on nature-based solutions (NbS) on the JC3 website (www.jc3malaysia.com).

Diagram 7: Bank Negara Malaysia's Key Focus Areas for 2024



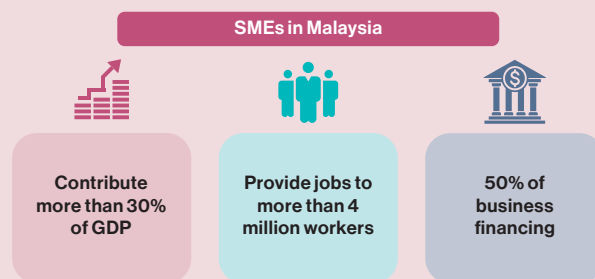
Sumber: Bank Negara Malaysia

Supporting SMEs Transition to Greener Practices

In many countries, SMEs are the critical contributors to economic growth. This is true for Malaysia as well, with SMEs accounting for 97%¹ of all business establishments. SMEs provide employment to around 48%¹ of the Malaysian workforce, making them the backbone of the domestic economy (Diagram 1). As key players in the global and domestic supply chain, SMEs are crucial to achieve an orderly transition for Malaysia to a low carbon economy in line with the Paris Agreement goal² to mitigate the harmful effects of global warming.

This article outlines the risks and opportunities for SMEs arising from the effects of climate change, ways SMEs can embrace sustainability practices and the support provided by BNM and the financial sector.

Diagram 1: Significance of SMEs in Malaysia



Source: Bank Negara Malaysia and Department of Statistics, Malaysia

Risks and opportunities

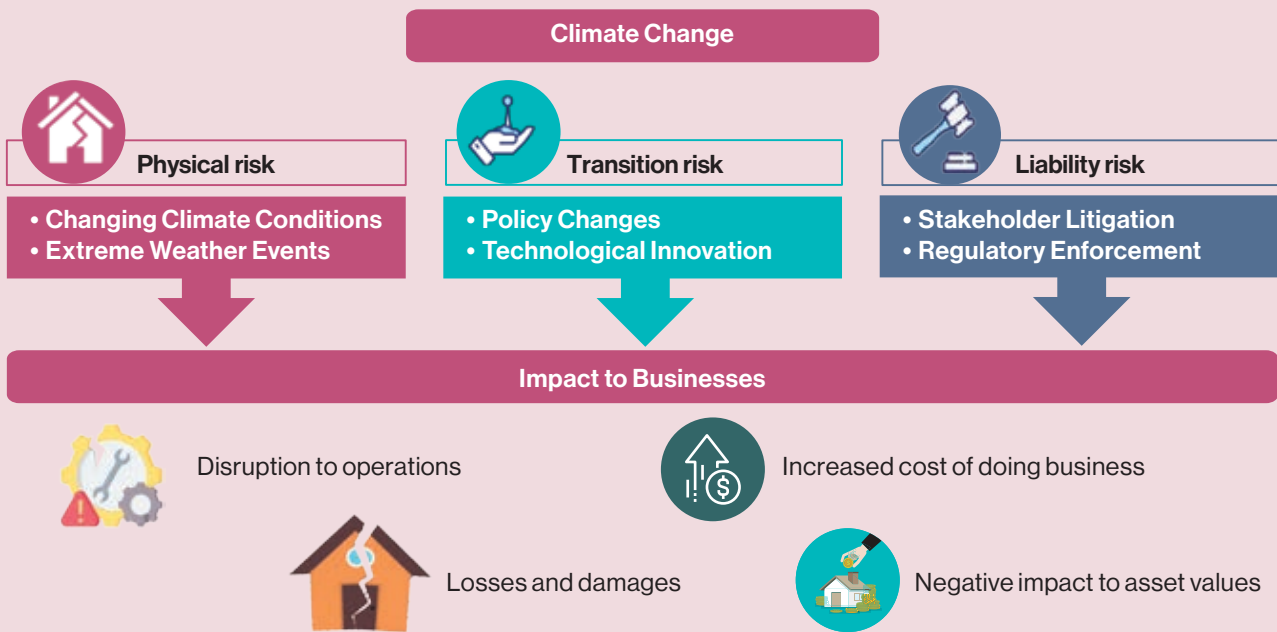
The direct impacts of climate change on the operations of SMEs do not only come from extreme weather events (Diagram 2). SMEs that are part of supply chains can be affected by green and sustainability-related policies of other economies, especially key trading partners as well as domestic producers. For example, mandatory climate-related disclosures have been implemented in more than 15 countries around the world while the European Union Carbon Border Adjustment Mechanism compels businesses, including SMEs, to demonstrate evidence of green and sustainable practices. Large domestic producers are also reducing their carbon footprint and expect suppliers to meet higher standards of sustainable practices. Failure to adopt sustainable practices could therefore put businesses at a significant disadvantage.

Climate change does not only pose risks to businesses. It also presents huge business opportunities from embracing sustainable practices and focusing on green activities (Diagram 3). A survey by UN Global Compact Network Malaysia & Brunei and SME Corporation highlights that 89% of SMEs adopting greener practices are experiencing average cost savings of 39%, with 11% achieving more than 50% cost savings.

¹ Data as at December 2022.

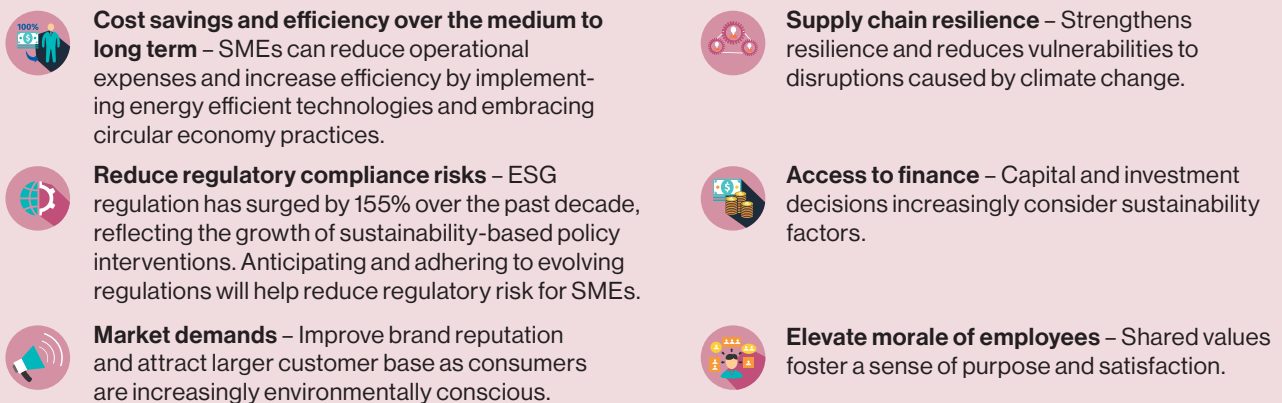
² The Paris Agreement is an international treaty under the United Nation Framework Convention on Climate Change (UNFCCC). It aims to limit global temperature rise to well below 2°C above pre-industrial levels.

Diagram 2: Impact of Climate Change on Businesses



Source: Bank Negara Malaysia

Diagram 3: Benefits of Adopting Green and Sustainable Practices



Source: Bank Negara Malaysia

Kickstarting the green transition journey

Knowing where and how to start is crucial. This allows SMEs to begin on the right footing and optimise the amount they spend and invest, and use of resources. A study conducted by BNM and the World Bank³ found that even Malaysian SMEs who understand the importance of transition are often unclear on where and how to begin. Diagram 4 outlines five key steps an SME can take to initiate the process.

³ Managing Flood Risks: Leveraging Finance for Business Resilience in Malaysia.

Diagram 4: Essential Steps to Initiate the Transition Journey



Source: Bank Negara Malaysia

To support Malaysian SMEs on this front, the JC3 ESG Jumpstart portal, a one-stop portal to guide SMEs in transition was launched by the Joint Committee on Climate Change (JC3) in October 2023. This portal houses various resources and tools, including guidance for SMEs to initiate their transition journey.

Initiatives and toolkits to support SMEs transition

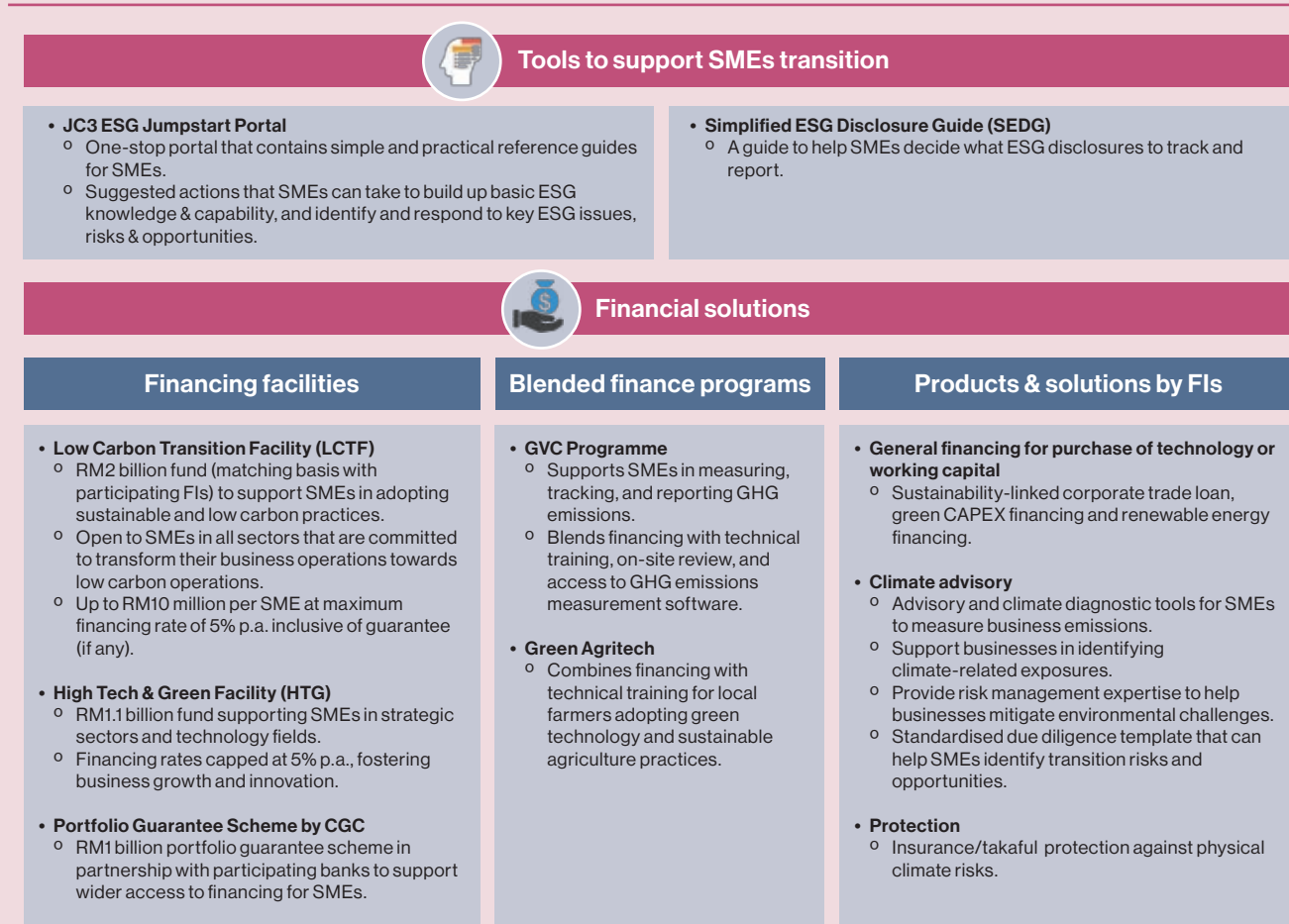
The financial sector plays a pivotal role in supporting businesses especially SMEs in their transition. Towards this end, BNM and the financial sector have introduced several initiatives to help SMEs build their technical capability and improve access to finance, as shown in Diagram 5.

Financing approved by BNM's Low Carbon Transition Facility (LCTF)⁴ and High Tech and Green Facility (HTG)⁵ increased further in 2023 to more than RM1.2 billion in financing approved to date. Both facilities have enabled more than 550 SMEs to start their transition journey. The Greening Value Chain (GVC) pilot programme introduced last year has also supported more than 330 SMEs that are part of domestic supply chains. Under the GVC pilot programme, SMEs have access to technical training and tools to measure and report their GHG emissions, in addition to financing under LCTF. The cost of training and tools is borne by the participating anchor corporate or the financier. SMEs under the programme have begun to measure their GHG emissions, of which more than 40 have begun reporting emissions.

⁴ Launched in January 2022. Total size of RM 2.0 billion equally funded by BNM and participating financial institutions.

⁵ Launched in December 2020. Total size of RM 1.1 billion.

Diagram 5: Initiatives and Tools to Support SMEs in their Business Transition



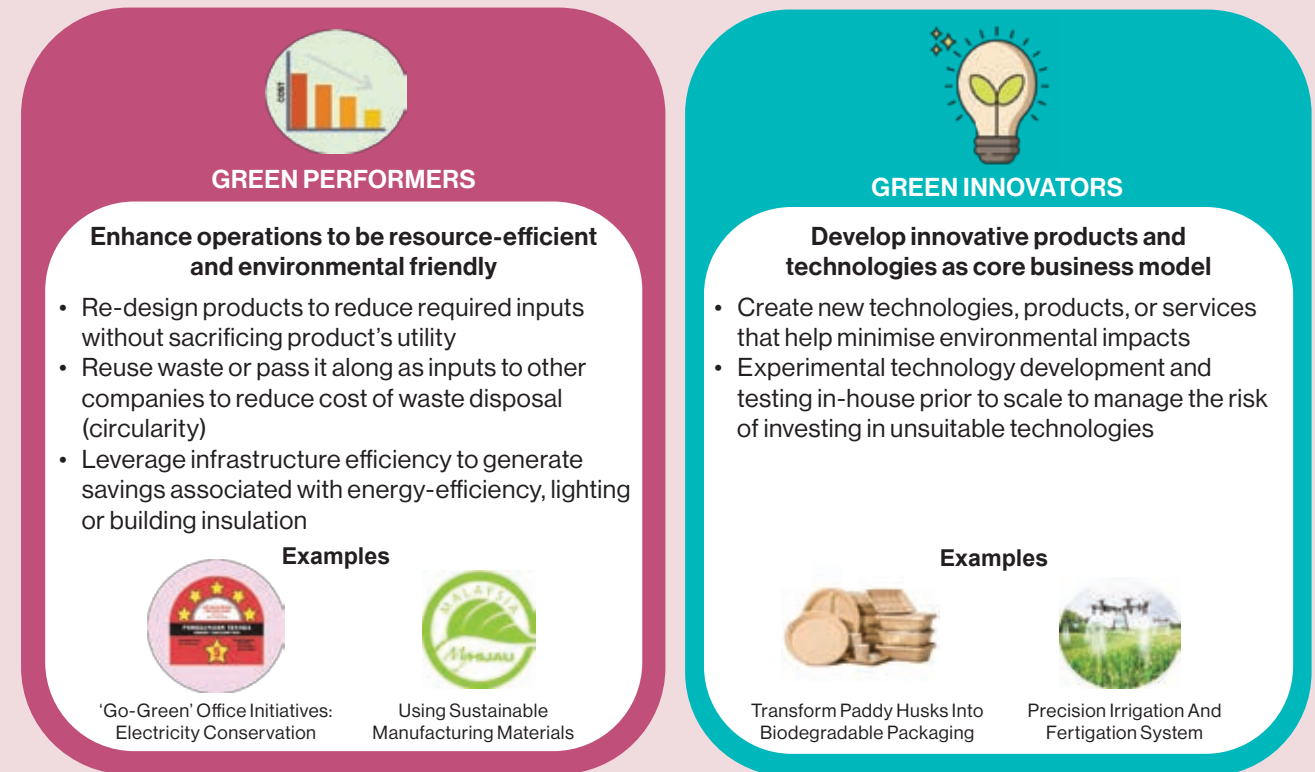
Source: Bank Negara Malaysia, JC3 and Financial Institutions' Websites

Start Small, Start Now, Do Our Part

There are at least two ways Malaysian SMEs can think about their role along this journey (Diagram 6). First, SMEs can be *green performers*. This means seeking to optimise the way they operate. This is achieved through resource efficiency and practices that are environmentally friendly to enhance business competitiveness. Second, SMEs can be *green innovators*. This means focusing on pioneering innovative green technologies. Both green performers and green innovators have a critical role to support a successful transition.

Greater cooperation and collaboration among SMEs can also contribute to the success of the transition efforts. Platforms and avenues for SMEs to share best practices, pool resources and collectively tackle challenges through networks and partnerships will accelerate the learning of many SMEs.

Diagram 6: Green Performers and Innovators



Source: Adapted from OECD and other sources

Different SMEs will be at different stages in their level of awareness and adoption of sustainability practices. This is natural and to be expected. What is more critical is that SMEs start to take important first steps and progressively intensify their efforts to meet aspirations for higher standards in sustainable practices. SMEs should kickstart their green transition journey now, utilising the available toolkits and solutions provided by the financial sector. Strategies by financial institutions to support the greening of SMEs must also be mainstreamed to secure an orderly and just transition of the economy where businesses regardless of size thrive, whilst contributing to a more sustainable and resilient future.

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