

Strategic Thrust 4

Position the financial system to facilitate an orderly transition to a greener economy

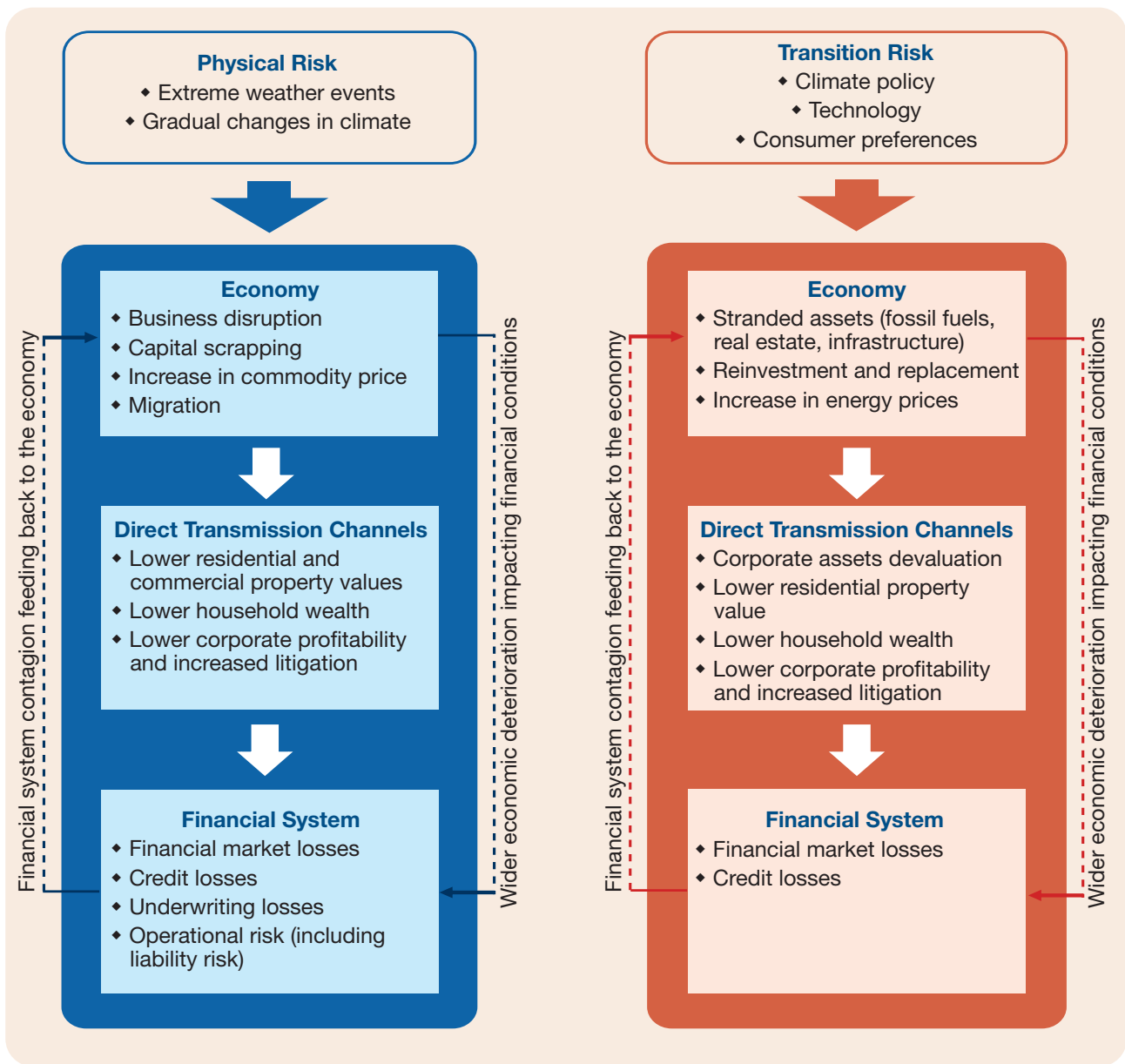
Climate change and environmental degradation pose unprecedented challenges and opportunities that will reshape the economic and financial landscape. These include:

- **Physical risk.** Extreme weather events and gradual shifts in the climate can damage property and disrupt business activity. Beyond putting livelihoods – and in extreme cases, lives – at risk, such developments also increase financial risk to financial institutions as the creditworthiness of materially affected borrowers deteriorate. In addition, this would lead to a higher cost of financial protection or the potential reduction in insurance and takaful capacity. Physical risk also impacts investment and collateral values, where assets can be destroyed or significantly damaged by climate or environment events.
- **Transition risk.** The adjustment to a low-carbon economy may entail changes to public policies, legislative and regulatory frameworks, technologies or societal responses – with possible consequences on the economy and financial sector. Globally, the pace of such adjustments is intensifying, with a growing list of nations and large organisations that have made carbon neutral or net-zero emissions commitments. Policies to promote a circular economy¹ are also gaining momentum, further contributing to changes aligned with environmental outcomes and longer-term socioeconomic prosperity. Shifts in consumer and investor expectations, regulatory pressure as well as technological advancements present risks to businesses. As an export-oriented economy, Malaysia will be directly affected by the transition efforts by major trading partners. A late or abrupt transition to these new trends could leave exposed businesses with stranded assets that experience an unexpected drop in value due to diminishing demand or regulatory restrictions. For financial institutions exposed to such businesses, these changes may translate into financial and reputational risks that could negatively impact their balance sheets and bottom lines.
- **Fiscal spillovers.** Beyond the losses to the economy and private finance, the materialisation of physical and transition risks will also have cascading effects to public finances. In addition to the Government's direct exposures, there is also the risk of spillovers such as through reduced tax revenue, higher sovereign spreads and substantial fiscal spending in the aftermath of a natural disaster.
- **Liability risk.** Governments, corporations as well as company directors and officers may also face higher prospects of legal action for failures to adequately address climate-related and environmental risks. Other than the cost of liability from successful lawsuits, such litigation can have a significant reputational impact on affected stakeholders. These risks may affect financial institutions that have extended liability protection, financing or investment to affected companies.



¹ A circular economy is an industrial system that is restorative or regenerative by intention and design. The idea is to gradually decouple economic activity from the unsustainable consumption of finite resources – and in turn, shift to systems designed to remove waste and pollution, keep products and materials in use and regenerate natural systems. Source: World Economic Forum (2014), "Towards the Circular Economy: Accelerating the Scale-up Across Global Supply Chains"; Ellen MacArthur Foundation (2020), "Financing the Circular Economy: Capturing the Opportunity".

Diagram 1:
Transmission of climate risk to the economy and financial system



Source: Network for Greening the Financial System (2020), "Guide for Supervisors: Integrating Climate-related and Environmental Risks into Prudential Supervision".

Against this backdrop, our primary focus will be to **promote financial system resilience** by continuing our efforts to improve climate-related and environmental risk management in the financial sector.

We will also seek to foster a **conducive market environment** for green financing and investment. Significant and concrete action is required to support an orderly transition by Malaysian households and businesses, and capitalise on opportunities from shifts to a low-carbon and sustainable economy. At this point, efforts needed to address climate-related and environmental risks – such as reskilling, the application of new technology, infrastructure upgrades, and the preservation of natural ecosystems – remain underfunded. In this regard, we will work to align legal and regulatory frameworks where appropriate², and

support mechanisms to mobilise mainstream finance in supporting the country's transition to a greener economy.

Given its central role in allocating and deploying economic resources, the financial sector can be the catalyst in encouraging players in the Malaysian economy to adopt more sustainable practices. At the same time, this should promote a **just and orderly transition** – that is, one which reinforces early and sustained actions to address climate change and environmental concerns, while adequately supporting affected communities to make the adjustments needed and ameliorate short-term impacts.

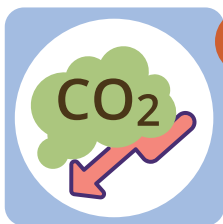
To achieve these goals, we will advance the following strategies (see Diagram 2 for an overview).

Diagram 2:
Position the financial system to facilitate an orderly transition to a greener economy



A Integrate climate-related and environmental risks in prudential regulation and supervision

- ◆ Ensure effective implementation of the Climate Change and Principle-based Taxonomy (CCPT) to facilitate the assessment of climate-related risks and encourage financial flows towards environmentally sustainable economic activities
- ◆ Align the prudential and supervisory framework to incorporate climate and environmental risk considerations
- ◆ Strengthen practices in the disclosure of climate risk by financial institutions



B Support orderly transition to a low-carbon economy

- ◆ Improve availability, access, and use of data for tackling climate change and environmental degradation
- ◆ Scale up green finance for a more sustainable Malaysia
- ◆ Collaborate with government agencies to align the financial sector's response with the national strategy towards achieving carbon neutral and net-zero targets
- ◆ Represent emerging market perspectives on sustainable finance developments and challenges



C Integrate climate risks in the Bank's internal functions and operations

- ◆ Enrich the scope of our macroeconomic and financial stability assessments to include climate and sustainability effects
- ◆ Manage our financial assets with greater consideration to climate and environmental risk
- ◆ Run our physical operations more sustainably

² Consistent with the Bank's mandate to promote a sound, progressive and inclusive financial system under section 5 of the Central Bank of Malaysia Act 2009.

Strategy 4A

Integrate climate-related and environmental risks in prudential regulation and supervision

Our efforts will be centred on aligning the financial sector regulatory and supervisory framework to account for climate-related as well as environmental physical and transition risks. This will build on a common framework for identifying and capturing climate-related and environmental risks across the financial sector to support risk assessments and disclosures.

To this end, we will continue the work of the Joint Committee on Climate Change (JC3)³ to advance the following outcomes for the financial sector:

- i. Ensure effective implementation of the Climate Change and Principle-based Taxonomy (CCPT)⁴ to facilitate the assessment of climate-related risks and encourage financial flows towards environmentally sustainable economic activities;
- ii. Align the prudential and supervisory framework to incorporate climate and environmental risk considerations; and
- iii. Strengthen practices in the disclosure of climate risk by financial institutions.



i Ensure effective implementation of the CCPT to facilitate the assessment of climate-related risks and encourage financial flows towards environmentally sustainable economic activities

- With the issuance of the CCPT in April 2021, our focus will be to work with the industry through the CCPT Implementation Group under the JC3 to **ensure that the taxonomy is implemented in a consistent and credible manner**. This would include enriching the repository of use cases to guide financial institutions in applying the CCPT.
- In addition to identifying and addressing implementation issues, we will work to **promote further integration and alignment with the Value-based Intermediation Assessment Framework (VBIAF) and its sectoral guides**, which provide

sector-specific⁵ toolkits for financial institutions to incorporate environmental, social and governance (ESG) risk considerations in their financing and investment decisions. Beyond this, we will also actively pursue broader efforts to promote comparability, alignment and interoperability with ESG-related taxonomies over time – such as the SC’s Sustainable and Responsible Investment taxonomy, the ASEAN Taxonomy for Sustainable Finance and others adopted at the global level, where appropriate. This will be important to spur external financing and foreign investments in mitigation and adaptation efforts.

³ The JC3 is a platform to pursue collaborative action for building climate resilience within the Malaysian financial sector. It is co-chaired by the Bank and the SC, with members comprising senior leaders from Bursa Malaysia, the financial industry and relevant subject matter experts. The JC3 comprises five sub-committees: Risk Management; Governance and Disclosure; Product and Innovation; Engagement and Capacity Building; and Bridging Data Gaps.

⁴ The CCPT guidance document was issued on 30 April 2021 to provide a common language for financial institutions to classify and report on climate-related exposures. Further details are accessible at <https://www.bnm.gov.my/documents/20124/938039/Climate+Change+and+Principle-based+Taxonomy.pdf>

⁵ To date, sectoral guides have been issued for the following six activities/sectors: Palm Oil; Renewable Energy; Energy Efficiency; Oil and Gas; Construction and Infrastructure; and Manufacturing.



The calibration of regulatory requirements will take into account the significant uncertainty, non-linearity, and forward-looking nature of these risks

ii Align the prudential and supervisory framework to incorporate climate and environmental risk considerations

- We will **strengthen our supervisory expectations for financial institutions to identify, measure, monitor, and manage exposures to climate-related and environmental risks**. This will include setting expectations for financial institutions to align business and risk strategies, with their sustainability commitments (such as net-zero milestones and green financing targets) and properly oversee transition plans.
- We will **review the existing prudential framework to align expectations for financial institutions to increase their resilience to climate and environmental risks**. This will include the consideration of relevant adjustments to prudential requirements (e.g. capital risk weights, the internal capital adequacy assessment process, counterparty exposure limits, and the treatment of collateral), where appropriate.

We will work with the industry and wider stakeholders to collect data and conduct research to inform any adjustments to the prudential framework. The calibration of regulatory requirements will consider the unique characteristics of such risks, including their significant uncertainty, non-linearity, and forward-looking nature. Supervisory judgment will therefore play an important role.
- We will also pay close attention to ensure that safeguards are in place to mitigate against greenwashing. Additionally, the regulatory framework will reflect the critical role and expectations for financial institutions to support transition activities. To this end, we will seek to ensure that financial institutions consider the needs of customers most vulnerable to physical and transition risks and support their efforts to adapt.
- We will also **continue to support industry efforts to expand the availability of intermediate and advanced technical programmes on climate-related risks** to strengthen the capabilities of financial sector professionals in the area of climate and environmental risk management. This includes partnering with subject matter experts from professional bodies and academic institutes, including International Centre for Education in Islamic Finance (INCEIF), Islamic Banking and Finance Institute Malaysia (IBFIM), the Asian Institute of Chartered Bankers (AICB), and the Asia School of Business (ASB), to develop structured training solutions relevant to the Malaysian context.





iii Strengthen practices in the disclosure of climate-related risks by financial institutions

■ We will **strengthen practices in the disclosure of climate-related risk exposures by financial institutions**. A clear roadmap will be announced for all financial institutions regulated by the Bank to make mandatory climate-related risk disclosures aligned with recommendations by the Task Force on Climate-related Financial Disclosures (TCFD). This aims to provide greater transparency to markets, sustain financial institutions' risk and business strategies that are aligned with climate considerations, and encourage cascading effects to also improve disclosures by the businesses that

they finance and invest in. Better quality disclosures will in turn facilitate financial flows to activities that support a more sustainable future.

The disclosure of climate-related risks is a critical step to address climate data gaps and accelerate the path to a net-zero emissions economy

Diagram 3:
Overview of the Task Force on Climate-related Financial Disclosures (TCFD)

| Thematic areas | Recommended disclosures | Principles for effective disclosure |
|---|---|--|
|  Governance | <ul style="list-style-type: none"> Board's oversight of climate risks and opportunities Management's role in assessing and managing climate risks and opportunities | <ul style="list-style-type: none"> Represent relevant information Specific and complete Clear, balanced and understandable Consistent over time Comparable among companies within a sector industry Reliable, verifiable and objective Provided on a timely basis |
|  Strategy | <ul style="list-style-type: none"> Impact of climate risks and opportunities on the organisation's businesses, strategy and financial planning Resilience of the organisation's strategy, taking into consideration different climate-related scenarios | |
|  Risk management | <ul style="list-style-type: none"> Organisation's processes for identifying, assessing and managing climate risks Integration of climate risks into the overall risk management | |
|  Metrics and targets | <ul style="list-style-type: none"> Metrics used to assess climate risks and opportunities in line with strategy and risk management processes Greenhouse gas emissions Targets used to manage climate risks and opportunities, and performance against targets | |

Source: TCFD (2017), "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures".

Strategy 4B

Support orderly transition to a low-carbon economy

Environmental challenges – including climate change – are highly complex. Addressing them effectively requires concerted efforts across a wide range of stakeholders, often beyond national borders, and on a sustained basis.

The financial sector has a significant role to play in this regard. The pathway to carbon neutral and ultimately net zero will require significant green investments and transition finance to be channelled towards initiatives that reduce Malaysia's carbon footprint (e.g. renewable energy solutions, rethinking transport, low-carbon cities), and improve climate resilience (e.g. safeguards against rising sea levels, extreme weather). Businesses will also need funding to pivot to new business models, recalibrate existing practices, and adopt new technology. In Malaysia, demand for green investment funds is expected to grow to RM76.2 billion by 2030⁶, and much more investment will be needed over the coming years to fund Malaysia's journey to net-zero emissions and broader sustainability transition. It is thus crucial that financial institutions urgently step up and mobilise capital to support the increasing demand for green and transition funds in the period ahead.

Meeting this need calls for a significant scaling up of both public and private sources of funding in a manner that takes full advantage of the growing global demand for meaningful and measurable green investment opportunities. In this regard, the implementation of the CCPT by financial institutions will play an important role to help channel funds to investible green projects.

To complement the role of financial institutions, strategies to enhance the landscape (set out in chapter "Fund Malaysia's economic transformation") will also give specific focus to addressing funding gaps for high priority green projects, where the risks – or opportunities – posed by climate change are particularly prominent for the Malaysian economy. This includes utilising a diverse array of financing instruments, such as alternative finance, to meet the various needs of green finance priorities.

Government policies will also need to work in tandem, to remove barriers or incentivise more sustainable economic models. A clear national policy will provide the foundations for a cohesive reform agenda by public sector agencies, regulators, businesses, civil society, and consumers alike. This will also need to be supported by capacity-building efforts to expand access to the necessary skills, knowledge, technologies and data to advance climate- and environment-related reforms.

We are committed to play our role as a central bank and financial regulator within this broader 'whole-of-government' and 'whole-of-society' endeavour. In particular, we will seek to advance the following:

- i. Improve availability, access, and use of data for tackling climate change and environmental degradation;
- ii. Scale up green finance for a more sustainable Malaysia;
- iii. Collaborate with government agencies to align the financial sector's response with the national strategy towards achieving carbon neutral and net-zero targets; and
- iv. Represent emerging market perspectives on sustainable finance developments and challenges.

⁶ Source: Ministry of Energy, Green Technology and Water Malaysia (2017), "Green Technology Master Plan Malaysia 2017-2030".

i Improve availability, access, and use of data for tackling climate change and environmental degradation

The availability and transparency of climate-related data in Malaysia is a prerequisite for effective risk management in the financial sector

■ We will **facilitate the application of advanced digital tools to address the needs of the financial sector for accurate, granular and location-specific data** to support climate risk mitigation and adaptation use cases. For instance, such a broad range of data can help:

- Anticipate physical risk incidents (e.g. droughts, floods) and resulting economic losses, and thus inform and reward adaptation efforts through lower insurance premiums / takaful contributions;

- Increase the speed of insurance and takaful claims, by tying pay-outs to predefined climate-related triggers (e.g. flooding exceeding a certain threshold) without the need to assess actual loss or damage to physical assets;
- Reliably track emissions to validate sustainability practices and address risks of greenwashing; and
- Remotely measure and verify carbon capture in rainforests to provide efficient assurance for voluntary carbon markets and emissions trading schemes.

■ We will work through the JC3 Sub-committee on Bridging Data Gaps to collaborate with government agencies, academic institutes, technology firms and other relevant players to **identify critical data needs and create open access to relevant data sources** to continuously improve the availability of data crucial to climate risk and business strategies.



We will develop specialised funding mechanisms for green finance and support efforts to develop carbon markets

ii Scale up green finance for a more sustainable Malaysian economy

■ We will **work with industry players such as Cagamas Berhad, CGC and the development financial institutions to further develop and expand specialised funding and risk mitigation mechanisms**, such as the Low Carbon Transition Facility (LCTF) and Green Technology Financing Scheme (GTFS). This will aim to encourage the scaling up of green finance, particularly for SMEs, through targeted credit enhancements and

protection, and access to lower-cost funding for climate supporting and transition activities. We will also support efforts to involve the financial sector in developing carbon markets – such as the domestic emissions trading scheme and voluntary carbon market – in order to promote better pricing of emissions externalities and increase capital flows to nature-based solutions such as rainforest conservation.

We will actively pursue collaborative strategies to align our sustainability agenda with the Government's policy and initiatives

iii Collaborate with government agencies to align the financial sector's response with the national strategy towards achieving carbon neutral and net-zero targets

- We will **continue to align our efforts with Malaysia's broader objective to advance sustainability, as outlined in the RMK12 and in accordance with the national strategy set by the Malaysia Climate Action Council (MyCAC).** Financial sector policies and initiatives, including those set out above to build financial sector resilience and foster a conducive environment for green financing and investment, will take into account the nation's commitments under the Paris Agreement and the introduction of climate change legislation that will formalise the nation's climate targets and timeline to achieve net-zero greenhouse gas emissions.
- To **promote synergy between national-level policies and financial sector initiatives**, we will also work closely with relevant stakeholders to encourage timely and coordinated action in high priority areas under the forthcoming Malaysia sustainable finance roadmap. Particular focus will be given to securing an orderly transition, strengthening physical risk adaptation, as well as promoting areas of competitive advantage.

iv Represent emerging market perspectives on sustainable finance developments and challenges

It is critical for global efforts to deliver equitable outcomes

- An inclusive global approach to fighting climate change is crucial to deliver equitable outcomes for all. With this in view, we will **continue to participate in international efforts to advance emerging market and ASEAN perspectives on sustainable finance.** Support for emerging economies to manage transition spillovers from the growing international momentum toward net zero (e.g. reduced market access and job losses due to changes in demand and regulations) will be particularly important, with many emerging economies also challenged by severe physical risks and striving to lift a significant portion of its population out of poverty. At the same time, many are home to highly valuable but under-priced natural capital with potential as global carbon sinks and biodiversity banks.
- Through the Bank's membership in the Network for Greening the Financial System (NGFS) and involvement in other international standard setting bodies and platforms, we will seek to **encourage meaningful cooperation to accelerate capacity building initiatives and inform global strategies and standards on climate risks and sustainable finance.**
- Within the region, we will **continue to work closely with the South East Asian Central Banks (SEACEN), the ASEAN Finance Ministers and Central Bank Governors, as well as other partners to tackle common issues faced in climate and environmental risk management.** This includes addressing data limitations across the region to support better risk surveillance and cooperating to further strengthen the regulatory and supervisory framework. We will also support broader efforts in the development of an ASEAN Green Map to promote a comprehensive and unified approach to addressing sustainability issues across banking, insurance, and capital markets in the region.

Strategy 4C

Integrate climate risks in the Bank’s internal functions and operations

Within our organisation, we are taking a holistic approach to integrate climate risk and sustainability considerations in delivering our mandate.

To this end, we will seek to advance the following:

- i. Enrich the scope of our macroeconomic and financial stability assessments to include climate and sustainability effects;
- ii. Manage our financial assets with greater consideration to climate and environmental risks; and
- iii. Run our physical operations more sustainably.

i Enrich the scope of our macroeconomic and financial stability assessments to include climate and sustainability effects

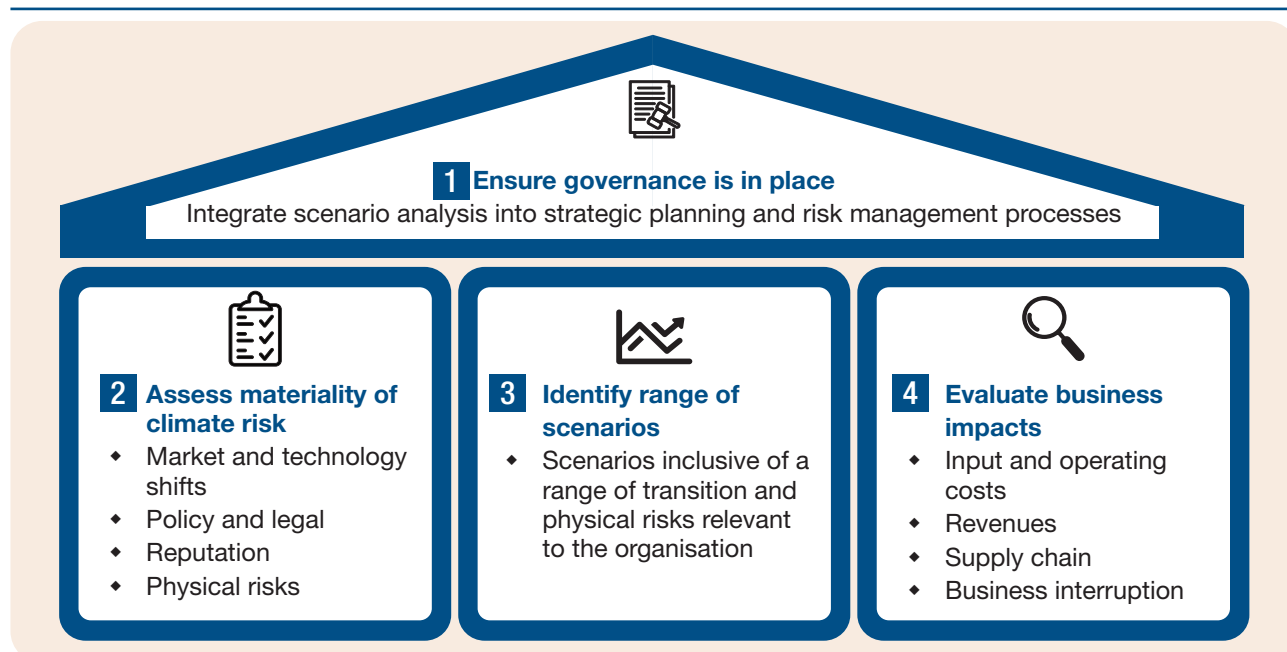
We will commit to manage climate risk across our policy functions and reduce emissions from our physical operations

- We aim to **conduct climate risk stress tests for the financial industry by 2024**. These stress tests will assess the impact of climate change on the balance sheets of financial institutions over the next 30 years and estimate the potential financial losses that may result. This will be supplemented by efforts to model the macroeconomic and financial system impact of climate shocks based on various climate

scenarios, building on the scenarios developed by the NGFS.

- We will **enhance our surveillance and forecasting work to better understand the possible effects of climate change on key macroeconomic variables**. This will include engaging business leaders and other relevant stakeholders to better understand the transmission of physical and transition risks to the real sector, including the knock-on effects throughout the supply chain. We will also seek to better understand the implications of these changes on the conduct of monetary policy.

Diagram 4:
Overview of scenario analysis process



Source: TCFD (2017), “Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities”.

ii Manage our financial assets with greater consideration to climate and environmental risks

- We will **adopt the recommendations of the TCFD and continue to enhance our climate-related financial disclosures, building on disclosures made since 2020.** Efforts will be directed at expanding disclosures to include risk management, metrics and targets relevant to the Bank's operations.
- We will **incorporate climate and environmental risk considerations into our portfolio management activities.** This aims to manage our own exposure to climate and environmental risks, as well as contribute to the transition towards reduced emissions, in a manner that is consistent with our investment objectives. Our investment strategies will take into account ESG factors and principles of Sustainable and Responsible Investment (SRI) as we consciously manage the environmental impact of our portfolio in line with sustainable financial returns.

iii Run our physical operations more sustainably

- In the management of our facilities, we will seek to **improve energy efficiency and move toward principles of circularity in waste management.**
- On currency management, we will **continue to promote the issuance and usage of longer-lifespan polymer banknotes** that will reduce banknote disposal volumes over time. We will also explore more sustainable ways to dispose shredded banknotes while doubling-down on efforts to accelerate the adoption of e-payments, which will also promote the broader digitalisation agenda.



