

# Towards a Greener Financial System

An orderly and just<sup>1</sup> transition is crucial for Malaysia to avoid major economic and societal impacts and reap green growth opportunities, as we strive towards net zero GHG<sup>2</sup> emissions by 2050.

## Introduction

The effects of climate change continue to be widespread and increasingly visible, impacting our nation, economy and financial system. There is growing consensus that urgent actions are needed to decarbonise the global economy to mitigate the rising impact of climate change. Towards achieving this goal, many nations have committed towards net zero GHG emissions in the next three to four decades. For Malaysia, the Government has pledged to achieve this target by 2050.

The Bank spent the year focused on stepping up its response and driving collective action on climate risks within the financial sector. This is crucial in building a financial sector that is resilient to climate change and one that lends support towards greening the economy. Specifically, we continued to play a formative role in building the capacity of our financial institutions. This includes strengthening capabilities to measure, mitigate and protect against climate risks. Within the Bank, we continued to take steps to green our operations. At the macro level, we focused on aligning the financial sector's response to climate risks with national policies and strategies. This includes supporting sustainability-related policies as outlined in the Twelfth Malaysia Plan and the national budget. We also actively provide emerging market views on climate

issues at regional and international fronts, especially in relation to climate equity.

## More Structured Whole-of-bank Approach

Almost three years into the journey, we continue to strengthen our organisational approach to climate risk. This led to the setting up of the Sustainability Unit (SU) which is tasked to drive our efforts to integrate the green agenda across the Bank's functions and operations. Reporting directly to the Governor and senior management of the Bank, the SU coordinates and oversees the Bank's overall climate strategy and key initiatives. It provides technical and capacity building support to the six tracks of the Bank's key functions (Diagram 1). The SU also interacts with the Bank's Board on climate-related strategies, tapping on their knowledge and experience. At the senior management level, a Deputy Governor serves as the Executive Sponsor to provide broad guidance and direction to the SU. These developments support a sustained focus on and effective execution of our climate strategies.

Today, climate risks are regularly discussed at senior management and Board deliberations. This reflects growing consideration of climate-related risks in all aspects of our operations and functions.

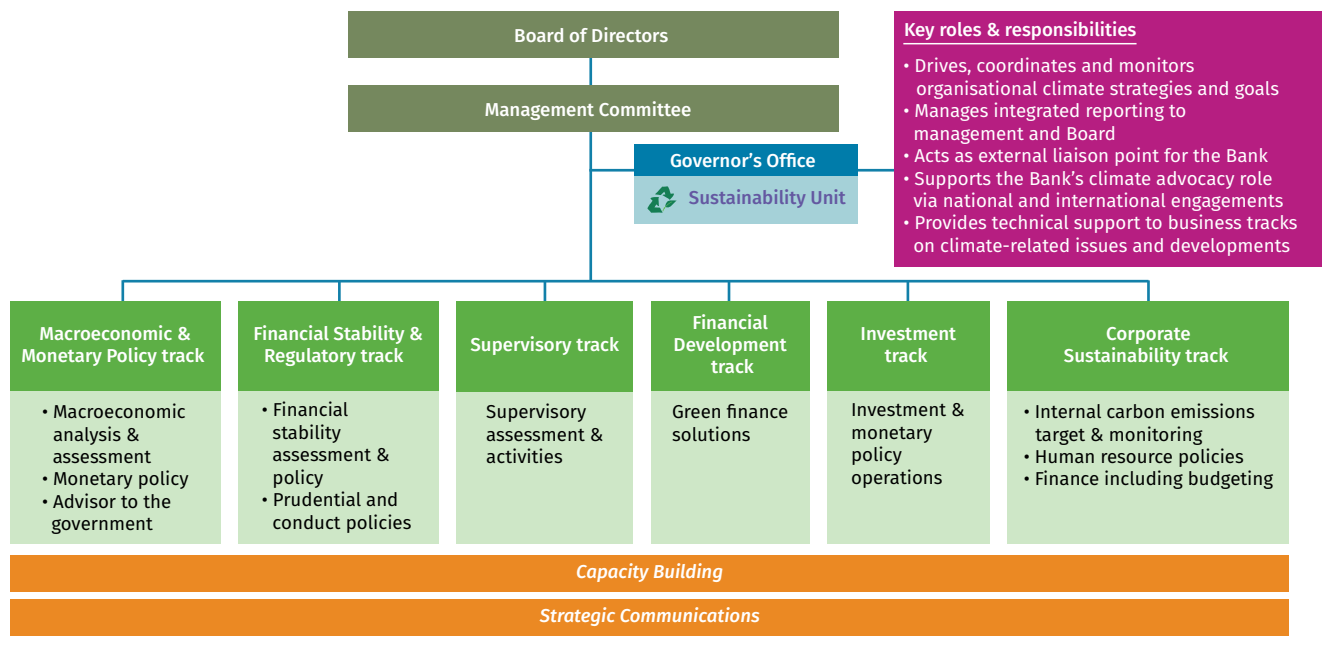
## Steady Outcomes in Advancing Climate Agenda

We made further progress in integrating climate-related risk considerations in our core functions (Diagram 2a & 2b). These include our supervisory assessments, prudential framework and assessments of macroeconomic and financial stability. We issued a number of key climate-related policies to further guide our regulatees. As we engage with the industry, we are encouraged that financial institutions are giving greater attention to climate-related risk areas. The

<sup>1</sup> Fair and inclusive with due consideration and adequate support for affected segments.

<sup>2</sup> Greenhouse gases, such as carbon dioxide, methane and nitrous oxide.

Diagram 1: Climate Considerations as an Organisational Priority



financial industry is also stepping up efforts to assist their clients to adopt sustainable practices.

We continued to take concrete steps to reduce our own carbon footprint. As we prepare staff to return to work at the Bank's premises post pandemic, we actively raise awareness of our staff on sustainable practices. On the investment front, we have set a higher target for ESG investments.

During the year, we also ramped up capacity building initiatives within the Bank. Our initiatives included knowledge sharing sessions and a series of structured capacity building programmes. We saw a similar trend within the financial industry. Such initiatives were supported by partnerships between the Bank, the Joint Committee on Climate Change (JC3) and external stakeholders such as FIDE Forum, the Islamic Banking and Finance Institute Malaysia (IBFIM) and entities responsible for the ASEAN Low Carbon Energy Programme.

## Greater Cohesive Response via the Joint Committee on Climate Change (JC3)

The Bank and its JC3 co-chair, the Securities Commission Malaysia continued to work closely with the financial industry through the JC3. Since

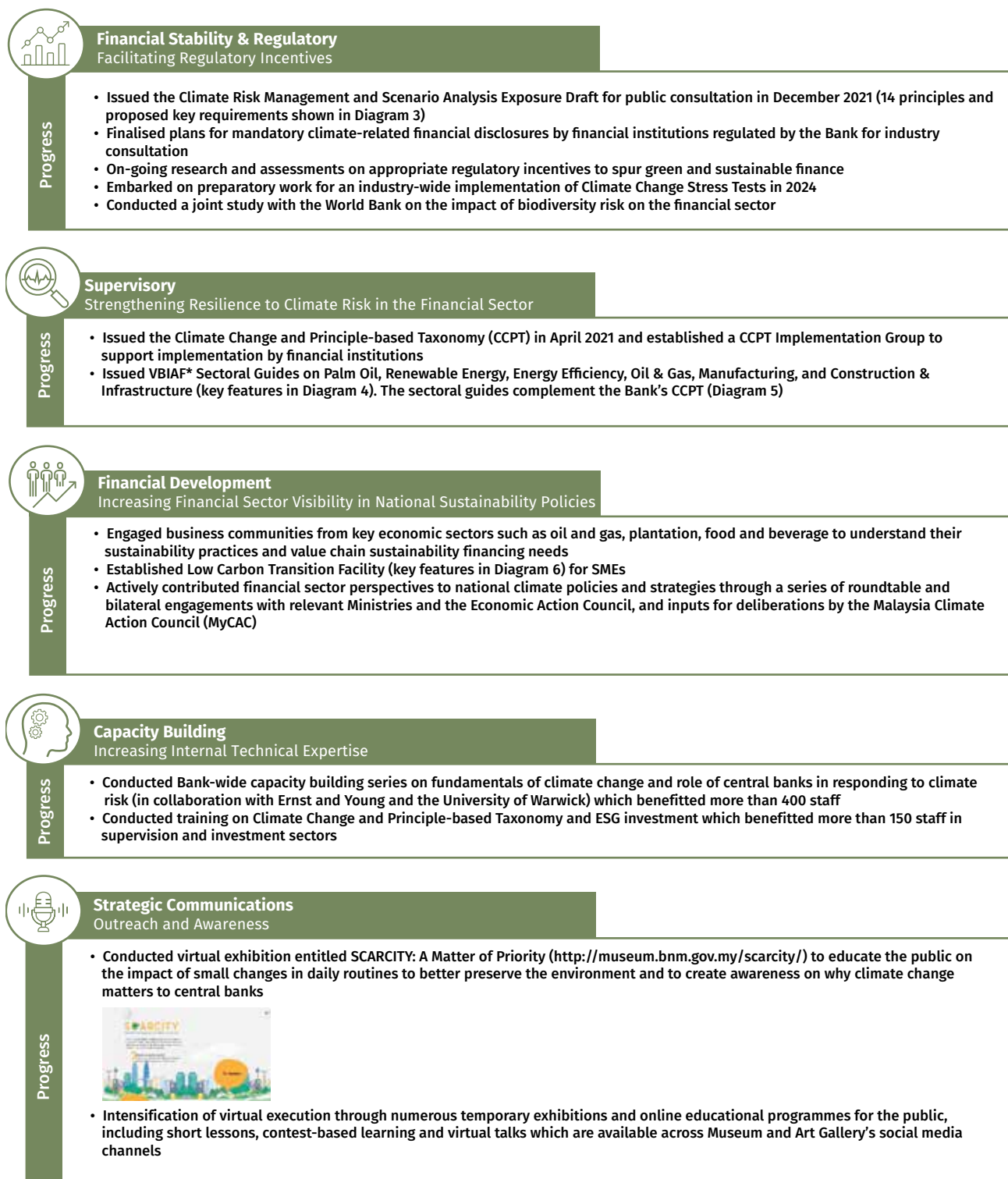
it was formed in 2019, JC3 has led and supported key climate initiatives in the financial sector. Its scope covers risk management, governance and disclosure, products and innovation, engagement and capacity building, and bridging data gaps (Diagram 7).

In 2021, JC3 continued to develop practical tools to aid financial institutions in assessing, managing and disclosing climate-related risks. Notably, we expect all financial institutions to make concrete progress towards disclosures of climate-related risks. This will be supported by the Application Guide on Climate-related Disclosures developed by JC3 for the industry. An additional workstream to address data gaps was also formed. As part of its broader outreach programme, JC3 organised its Flagship Conference which attracted about 6,300 participants from over 40 countries. The event urged the financial industry to step up its response to the climate challenge through calls for a set of concrete actions (Diagram 8). The report on key insights and discussions from the conference can be found at the Bank's website.

Diagram 2a: Progress and Outcomes of Initiatives for 2021



Diagram 2b: Progress and Outcomes of Initiatives for 2021



\* Value-based Intermediation Financing and Investment Impact Assessment Framework. The VBIAF Sectoral Guides provide an impact-based risk management toolkit for financial institutions to incorporate ESG risk considerations in their financing and investment decision making process (further details in the chapter "Promoting a Progressive and Inclusive Islamic Financial System").

Diagram 3: The 14 Principles and Proposed Key Requirements for Climate Risk Management and Scenario Analysis for Financial Institutions (FIs)



Diagram 4: Salient Features of VBIAF Sectoral Guides

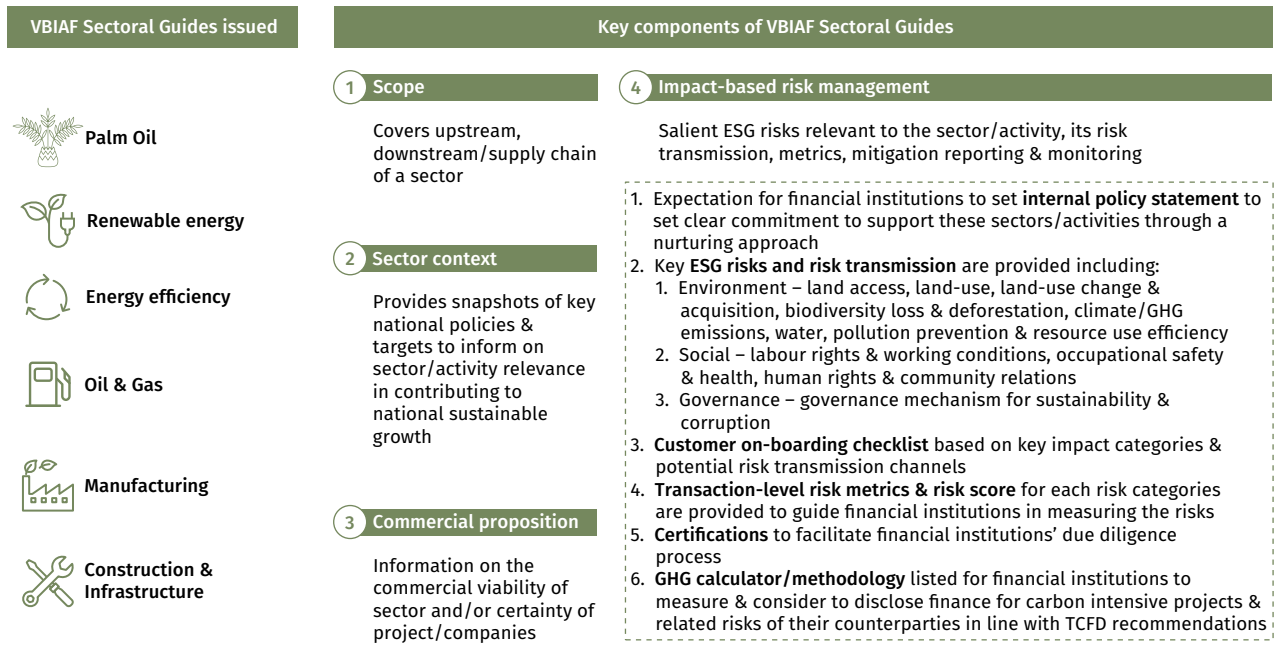


Diagram 5: Framework and Tools to Support Climate Risk Management

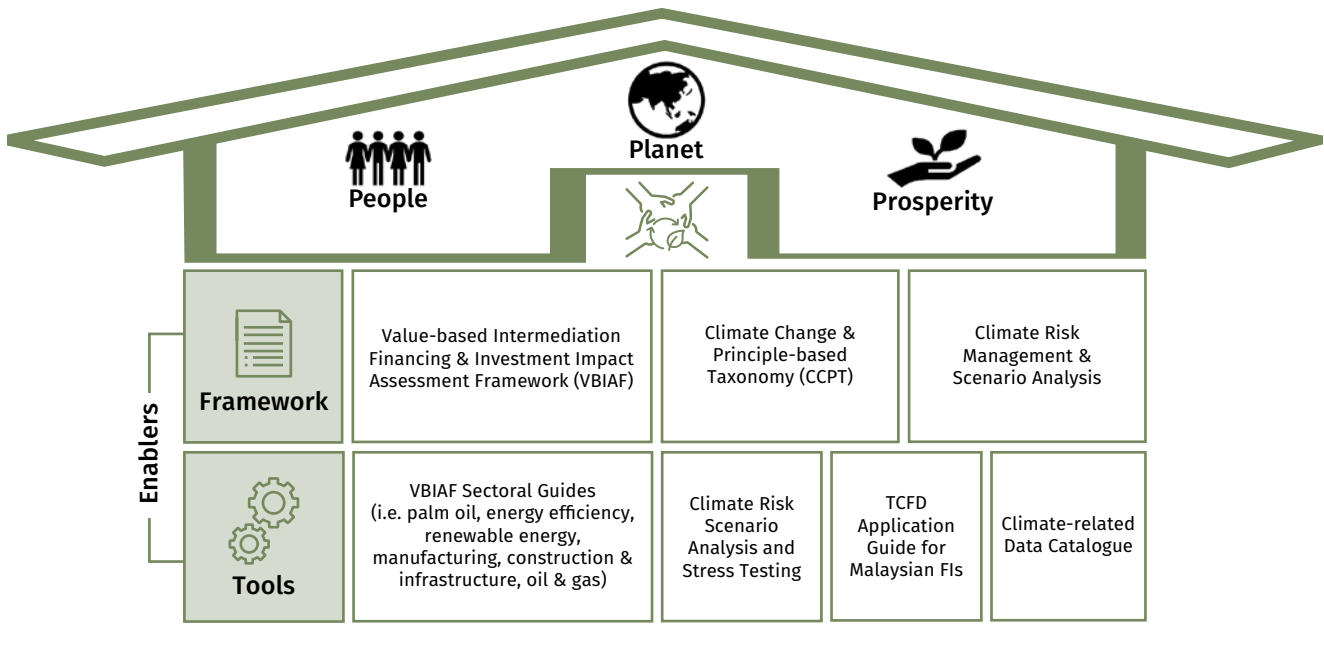
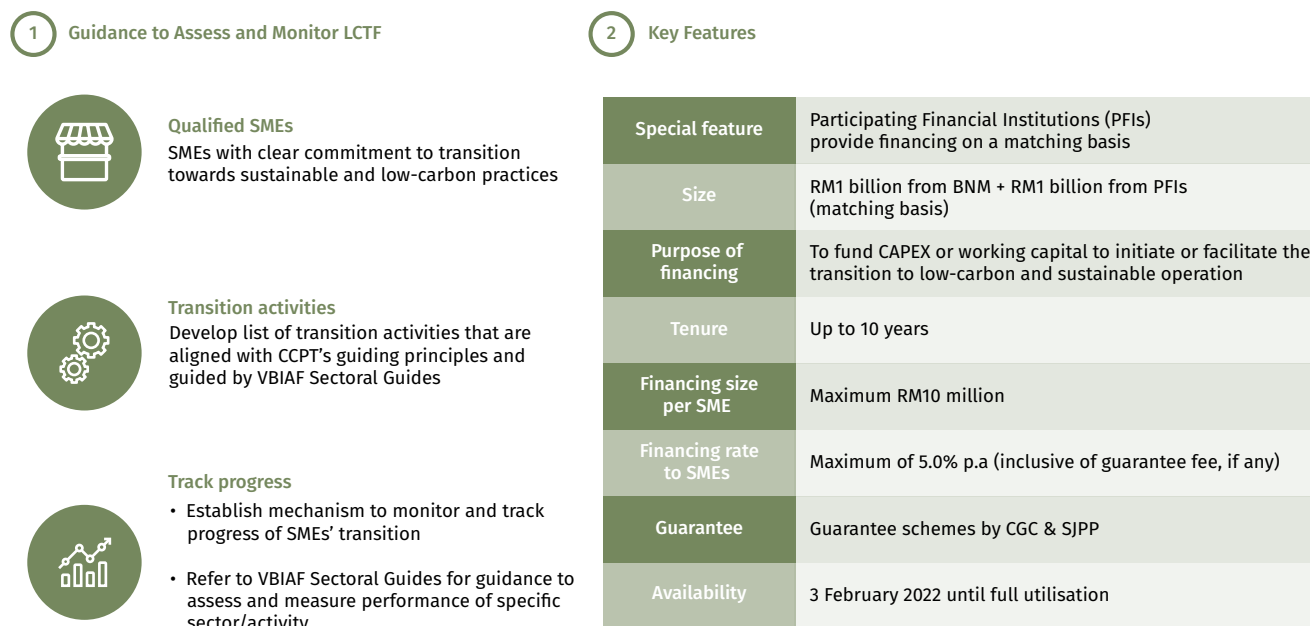


Diagram 6: Key Features of Low Carbon Transition Facility (LCTF)



Note: CGC - Credit Guarantee Corporation Malaysia Berhad, SJPP - Syarikat Jaminan Pembiayaan Perniagaan Berhad.

## Contributing to Regional and International Thought Leadership

On the regional front, 2021 was a significant year for the Bank. We are one of the eight founding members of the newly-formed ASEAN Taxonomy Board (ATB). The ATB is set up to develop, maintain and promote the ASEAN Taxonomy for Sustainable Finance (ASEAN Taxonomy). The ASEAN Taxonomy (Diagram 9) is a multi-tiered taxonomy to cater to varied standards of development and economic activity of ASEAN Member States (AMS). The Foundation Framework outlines a set of guiding principles, supported by qualitative screening criteria. The Foundation Framework can be applied by all AMS as a basis for classifying sustainable finance activities. The Plus Standard builds on the Foundation Framework to provide a more advanced classification system for green activities and investments. It applies science-based metrics and thresholds.

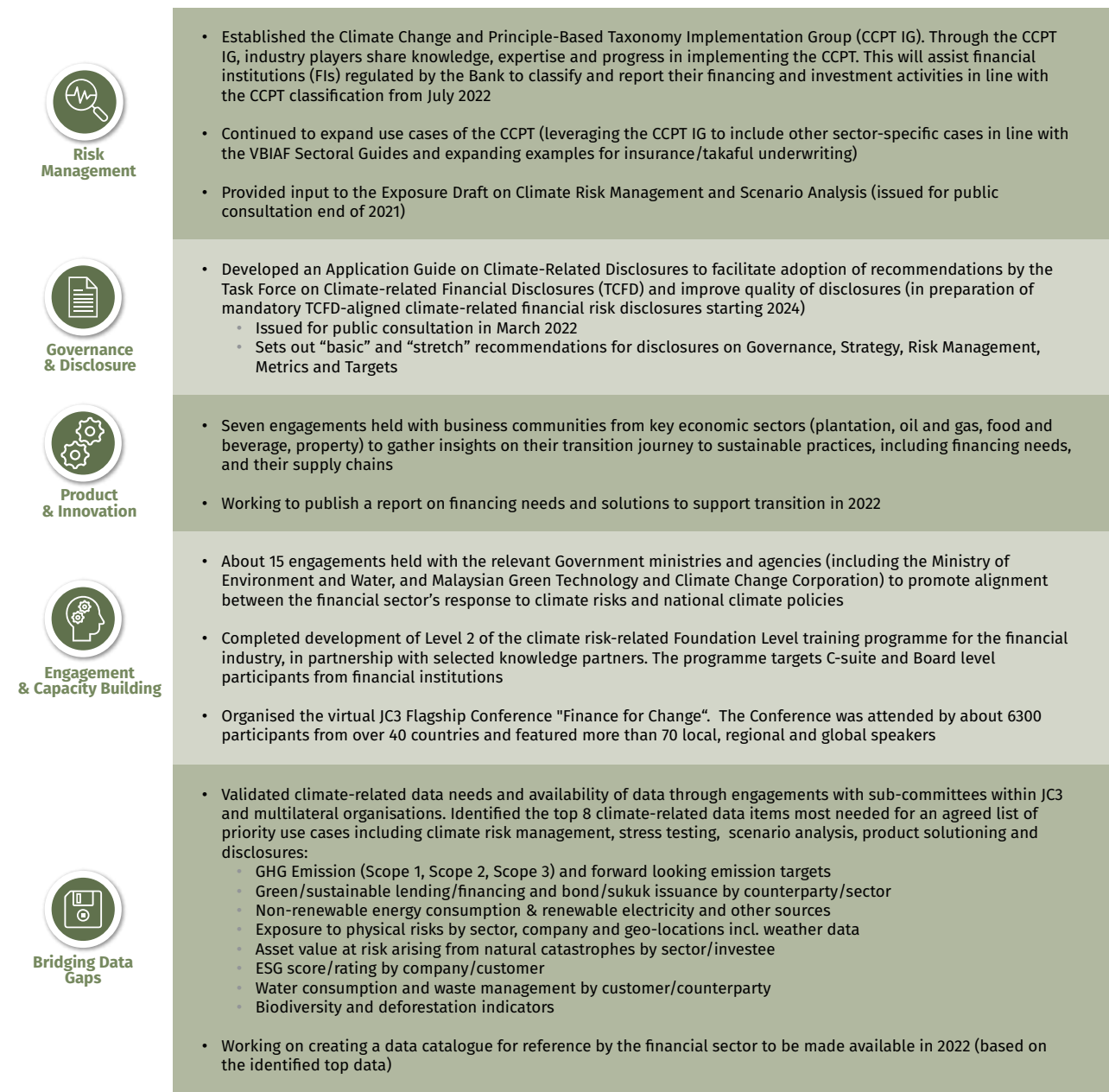
On 10 November 2021, in conjunction with the 26th United Nations Climate Change Conference of the Parties (COP26), the ATB released Version 1 of the ASEAN Taxonomy for consultation. This document sets out the conceptual framework that will form the basis for the principles, technical and operational features of the full ASEAN

Taxonomy. We played a key role in the issuance of the document. We chair Working Group 1 that developed the conceptual framework and principles for the Foundation Framework. We are also an active member of Working Group 2 that is developing the Plus Standard. For Malaysia, the CCPT issued by the Bank in April 2021<sup>3</sup> is aligned to the ASEAN Taxonomy.

Internationally, the Bank continued to actively contribute to emerging market perspectives on a number of climate issues. On climate equity, we stressed the importance for advanced economies to consider the disproportionate impact of their policies and actions on emerging economies. Equally important is the need to avoid the risk of financial exclusion. Developed countries have key roles to play. These include to support the transition of economic agents and meet pressing demands for capacity building. They have the means to assist smaller, developing countries adapt to climate change and take mitigating actions. They can contribute by providing capital, technology and expertise. This would improve climate equity and mitigate risks of disorderly transitions. We view these priorities to be critically important to

<sup>3</sup> Details can be found in a box article in BNM's Financial Stability Report 2H 2021.

Diagram 7: Progress of JC3 in 2021



encourage a globally consistent, inclusive and responsible response to climate-related risks by central banks, financial supervisors and the financial industry.

We continued to contribute to various work programmes and events focused on climate-related risks, particularly of the Central Banks and Supervisors Network for Greening the Financial System (NGFS), Executives’ Meeting of East Asia-Pacific Central Banks (EMEAP), and the Bank for International Settlements (BIS). The Bank is a member of the NGFS Steering Committee and five

NGFS workstreams. The workstreams focus on microprudential and supervision, macroprudential, scaling up green finance, research, and bridging data gaps. During the year, we issued a Pledge on our commitment in relation to climate risk management, disclosure and capacity building (Diagram 10) in support of the global climate response and work of the NGFS.

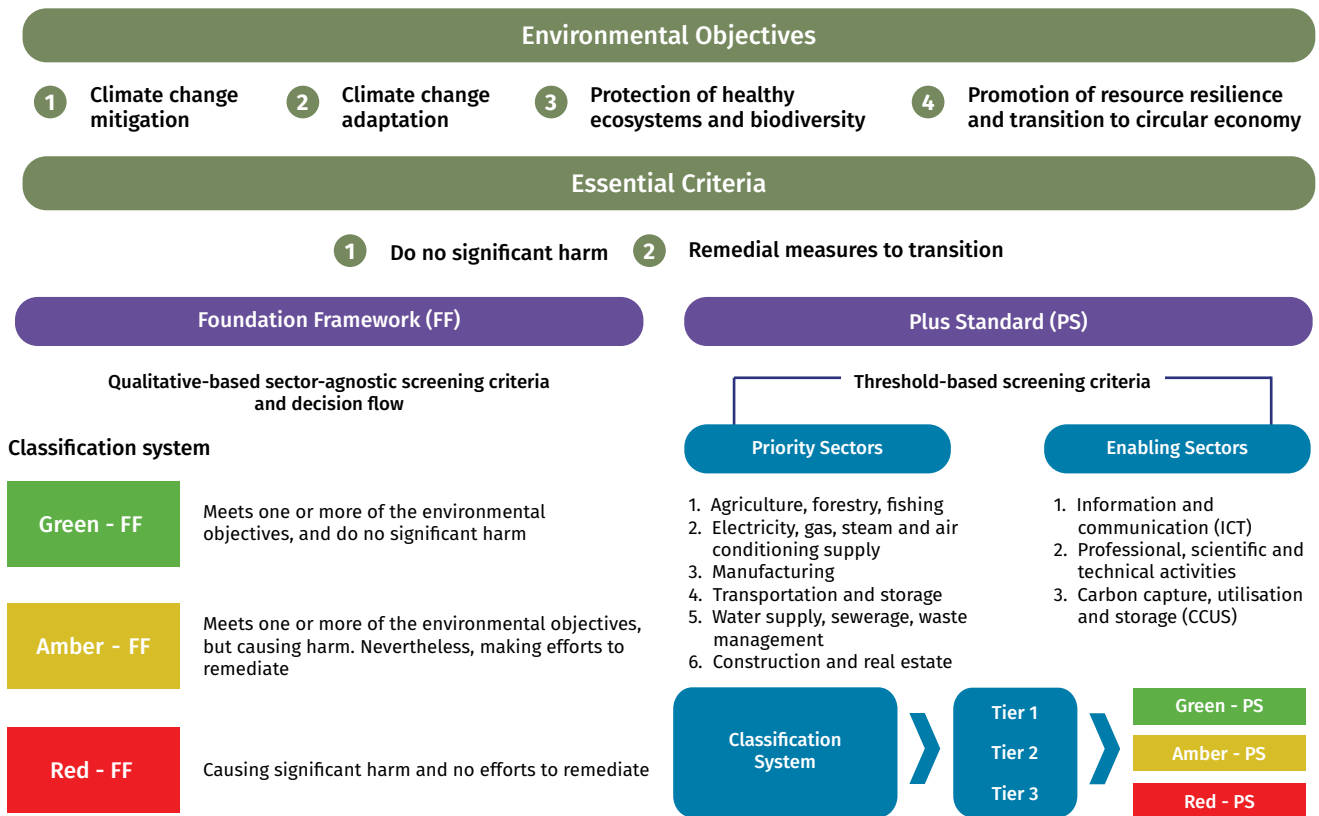
Malaysia is a nation that is rich in biodiversity. As we progress efforts on the climate front, we recognise that building capacity on the broader topic of nature loss is crucial to complement our

Diagram 8: Summary of Call to Action From JC3 Flagship Conference Rapporteur Report



Source: <https://www.bnm.gov.my/documents/20124/3770663/20210803-JC3-Flagship-Conference-2021-Report.pdf>

Diagram 9: Overview of the ASEAN Taxonomy on Sustainable Finance



Source: Bank Negara Malaysia, adapted from publication by the ASEAN Taxonomy Board

work on climate-related risks. Specifically, we need to understand the interactions between biodiversity and climate risks and how these affect the financial sector. On this front, we participated in the NGFS Study Group on Biodiversity. We also worked closely with the World Bank on a research work on nature-

related risks in Malaysia during the year, the first of such study for the Asian region. The outcome of this joint research is a report<sup>4</sup> that focuses on how, and to

<sup>4</sup> An Exploration of Nature-related Financial Risks in Malaysia - <https://www.bnm.gov.my/documents/20124/3770663/ibrd-2022-nature-financial-risk.pdf>.



Governor Nor Shamsiah Yunus as a panellist in a Fireside Chat at COP26 Finance Day hosted by the World Bank Group and Banque de France.



Governor Nor Shamsiah Yunus as a panellist in a Fireside Chat at BIS-BDF-IMF-NGFS Green Swan 2021 Global Conference.

what extent, banks in Malaysia could be exposed to risks from biodiversity loss and ecosystem damage. The report was recently launched on 15 March 2022 to raise awareness and stimulate dialogue on this important topic.

### Increasing Awareness Through Communication

Our senior management and officers participated actively as speakers in climate-related events.

This allows us to share our initiatives and views especially on the important role of the financial sector in facilitating an orderly and just economic transition. On the domestic front, these include virtual dialogues organised by the FIDE Forum on The 2050 Net Zero Carbon Emissions Target: Finance's Role, EAC Dialogue organised by the Economic Action Council (EAC) Secretariat and Series 1 of the National OGSE Sustainability Forum organised by Malaysia Petroleum Resources Corporation. At the global level, we also participated in the Minister Level Meeting of the Coalition of Finance Ministers for Climate Action,



Deputy Governor Jessica Chew as a speaker at the World Bank's Sustainable Exchange Development Series (SEEDS) - Developments in Sustainable Finance in ASEAN.

Diagram 10: Key Features of BNM's Pledge

| 6 Areas   | 14 Commitments   |
|---|--|
| <b>Financial stability monitoring and micro-supervision</b> | <ul style="list-style-type: none"> <li>• Advance preparations for an industry-wide climate change stress test</li> <li>• Incorporate climate-related risks as part of formal supervisory assessments</li> <li>• Develop a Reference Guide on Risk Management and Scenario Analysis for financial institutions (FIs)</li> <li>• Implement structured climate-related technical training for regulatory and supervisory staff</li> </ul> |
| <b>Taxonomy</b>   | <ul style="list-style-type: none"> <li>• Ensure consistent and credible implementation of CCPT</li> </ul>  |
| <b>Data gaps</b>  | <ul style="list-style-type: none"> <li>• Lead and provide dedicated resources for JC3 Sub-committee on Bridging Data Gaps – to meet critical data needs of industry to manage climate-and environmental-related risks and structure green solutions</li> </ul>   |
| <b>Capacity building &amp; awareness</b>                    | <ul style="list-style-type: none"> <li>• Ramp up engagement and capacity building efforts through JC3</li> <li>• Expand suite of technical programmes developed under JC3</li> <li>• Support NGFS capacity building initiatives</li> </ul>   |
| <b>Disclosure</b>   | <ul style="list-style-type: none"> <li>• Improve climate-related risk financial disclosures</li> <li>• Develop a guide for FIs to adopt climate-related disclosures</li> <li>• Continue to disclose own climate initiatives in BNM Annual Report</li> </ul>  |
| <b>Portfolio management</b>                                 | <ul style="list-style-type: none"> <li>• Strengthen internal frameworks for integrating sustainability factors in own portfolio management</li> <li>• Assess how climate change would feed into monetary policy</li> </ul>   |

the World Bank's Sustainable Exchange Development Series, ESG GO ASEAN Summit 2021 and the Fireside Chat at COP26 Finance Day.

## Climate Risk Management and Target Setting

Today, climate risk is being actively considered in our operations and frameworks. We are taking steps to further deepen our understanding of the underlying risks. We are also building technical capabilities to systematically measure our carbon emissions. This will pave the way towards setting our internal emission targets in 2022.

## Going Forward

For Malaysia, achieving net zero GHG emissions by 2050 will protect the environment for our future generations and will also bring about wider economic prosperity. Beyond reducing the risk of catastrophic climate events,<sup>5</sup> as many as 232,000 jobs could be supported in a green industrial revolution. Malaysia can achieve this through capturing green growth opportunities.<sup>6</sup> This includes new green industries such as renewable energy, hydrogen

<sup>5</sup> Estimates by climate scientist suggest global warming would reduce economic welfare for Malaysia, measured by GDP per capita, by between 10-15% by 2100 (Burke, Davis et al., 2018).

<sup>6</sup> See 'Securing Our Future: Net Zero Pathways for Malaysia' Report (WWF-Malaysia & Boston Consulting Group, 2021).

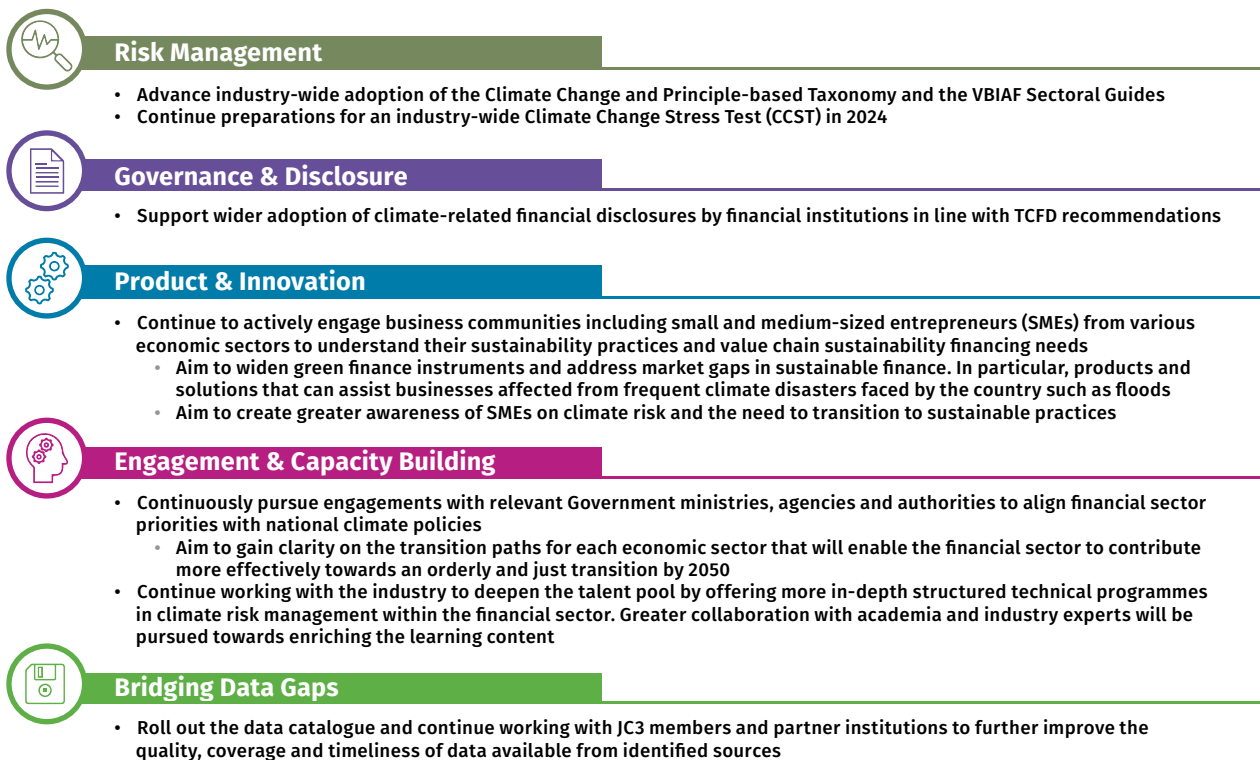
economy, electric vehicle (EV) manufacturing and energy efficiency solutions. An orderly and just transition will also protect the competitiveness of Malaysian businesses. It will cushion the impact from actions by capital providers, customers and trading partners which are sensitive to climate risk.

We aim to further support an orderly and just economy-wide transition for Malaysia through our policies and operations. The transition requires huge sums of private and public sector investments. We therefore focus on supporting and facilitating the financial sector's key role in enabling the transition to a low-carbon economy.

This is consistent with our statutory object to promote a sound, progressive and inclusive financial sector. Many opportunities are available for the financial sector to fund sustainability initiatives. These include projects under the National Investment Aspirations framework, the Malaysia Climate Action Council's plan for Malaysia to be a hub in green economy, services and technology and the Low Carbon Mobility Development Plan 2021-2030.

Overall, our initiatives (Diagram 11) are aligned with the Bank's five-year strategic vision for climate strategies as outlined in the Financial Sector Blueprint on Sustainability.

Diagram 11: BNM's Key Focus Areas for 2022



Source: Bank Negara Malaysia