

SHAPING A SUSTAINABLE FINANCIAL SYSTEM

Future-proofing global finance for a net-zero, nature-positive world

MALAYSIA

INTRODUCTION

Malaysia is one of the largest issuers of sukuk, Shariah-compliant financial instruments similar to bonds, with a

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share of global
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in 2021, Malaysia issued the world's first **US\$ sovereign sustainability sukuk** at **US\$1.3 billion**

The development of the local sustainable finance ecosystem in Malaysia is guided by the Joint Commission on Climate Change (JC3), co-convened in 2019 by the Securities Commission (SC) and Bank Negara Malaysia (BNM), the central bank. Malaysia's Socially Responsible Investing (SRI) Roadmap was issued by the SC in 2019.

The roadmap calls for broadening the range of available SRI instruments and building a stronger base of SRI issuers and investors. The roadmap also calls for developing appropriate governance mechanisms and addressing data gaps¹.

Islamic finance plays an important role in Malaysia's financial system. Malaysia is one of the largest issuers of sukuk, Shariah-compliant financial instruments similar to bonds, with a 41.5% share of global issuances in 2020². The framework for socially responsible sukuk was developed in 2014. The first sustainable sukuk was issued in 2015, and the first green sukuk was issued in 2017.

Islamic banking played a critical role in the development of sustainable finance in Malaysia, with the need for a green taxonomy becoming clear with the development of the Value-Based Intermediate Assessment Framework (VBIAF) developed by BNM, the central bank, which supports banks and other Financial Institutions (FIs) in considering sustainability in their lending decisions. The absence of an agreed upon taxonomy was identified by local Islamic banking entities as a major hurdle in the development of sustainable finance³.

As of 2020, Malaysia's market for sustainable finance stood at an estimated US\$2.6 billion⁴.

Of these, 67% of funds were allocated energy projects and 32% were used for buildings, with the rest classified for uses relating to issues including waste, water and land use. A total of fifteen green bond, sukuk, and loan deals have been issued since 2017, with sukuk comprising the majority. Bonds and sukuk are overwhelmingly issued in Malaysian ringgit and range in size from US\$30 million to US\$500 million, except for CIMB's 2019 US\$680 million SDGs Bond. In 2021, Malaysia issued the world's first US\$ sovereign sustainability sukuk at US\$1.3 billion.

An effective sustainable financial system for Malaysia will need to address deforestation, which has been identified by the IPCC as a nature-based solution that can help achieve net-zero commitments and the Paris Agreement more broadly⁵. Palm oil, a key forest risk commodity driving deforestation in both Malaysia and Indonesia (which together account for 87% of the world's palm oil production), plays a significant role in Malaysia's economy and in 2018 was the country's eighth-largest export⁶. Recognizing the link between deforestation in climate change, Malaysia identified forestry and biodiversity in its 2021 updated Nationally Determined Contribution (NDC)⁷. Policy instruments intended to create a sustainable finance ecosystem should therefore work in concert with Malaysia's fight against deforestation.

1. SC (2021): Sustainable and responsible investment roadmap for the Malaysian capital market.

2. Financial Centers for Sustainability (2020): FC4S welcomes Malaysia as 33rd member.

3. Hussain (2020): Defining green: Malaysia's big step towards sustainability.

4. Climate Bonds Initiative (2021): ASEAN Sustainable Finance State of the Market 2020.

5. IPCC (2019): Special Report on Climate Change and Land.

6. CDP (2020): Sustainability Risks for Southeast Asian Banks.

7. Government of Malaysia (2021): Malaysia's Update of its First Nationally Determined Contribution.

KEY SUSTAINABLE FINANCE POLICY ACTORS

Actor	Responsibilities and actions taken
BANK NEGARA MALAYSIA (BNM)	Central bank. Developed VBIAF and national taxonomy. Currently considering climate-related supervisory requirements for FIs. Member of JC3 and NGFS.
SECURITIES COMMISSION MALAYSIA (SC)	Developed of SRI Roadmap and SRI sukuk framework. Sponsors Malaysia Sustainable Finance Initiative (MSFI) and Green Technology Financing Taskforce (GTFS).
BURSA MALAYSIA (BM)	State-owned Enterprise (SOE) that functions as both regulator and market operator. Sustainable Stock Exchanges Initiative member and JC3.
JOINT COMMISSION ON CLIMATE CHANGE (JC3)	Coordinates efforts to build climate resilience in Malaysia’s financial system. Responsible for implementing local taxonomy, capacity building, and driving voluntary Task Force on Climate-related Financial Disclosures (TCFD). Chaired by BNM and SC.
MALAYSIA CARBON ACTION COUNCIL (MYCAC)	Chaired by the Prime Minister. Actions points include establishing an emissions trading scheme and developing a green recovery plan.



KEY SUSTAINABLE FINANCE POLICIES AND REGULATIONS

	Policy/Regulation	Supervisory/ Implementation	Implementing Agency	Sustainable Finance Positioning	Year of Implementation	Addresses Climate Change?	Addresses the Safeguarding of Water Resources?	Addresses the Protection of Forests?
1	Climate change and principles-based taxonomy (CCPT)	BNM	BNM	<p>The climate change and principles-based taxonomy (CCPT) provides a set of transition categories designed to identify and assess economic activities that support climate change mitigation and adaptation. The CCPT is guided by four principles:</p> <ul style="list-style-type: none"> ▼ GP1: Climate change mitigation, activities to reduce or prevent emissions of greenhouse gasses (GHG) into the atmosphere. ▼ GP2: Climate change adaptation, the process or actions taken to lower the negative effects and/or moderate harm caused by climate change. ▼ GP3: No significant harm to the environment, activities which could adversely impact the surrounding community and precipitate disruptions to overall climate resilience. ▼ GP4: Remedial measures to transition, measures to address significant harm identified at the economic activity level or the overall business level, or both. ▼ GP5: Prohibited activities, economic activities that are illegal or contravene environmental laws. <p>Through the application of these principles, economic activities are sorted into three buckets: climate supporting, transition, and watchlist activities. The taxonomy applies at both the transaction level and the company level. Companies engaged in environmentally harmful economic activities can still fall into the 'transition' category if they are understood to be taking credible remedial activities.</p> <p>CCPT users are encouraged to refer to sectoral guidelines produced for the VBIAF (detailed below).</p>	May 2021	x	x	x
2	Capital Markets Masterplan	SC	SC	<p>Lays out SC's vision for the Malaysian capital market between 2021 and 2025. Vision includes transforming Malaysia into a regional socially responsible investment (SRI) hub and closely ties progress on ESG issues to the growth of Islamic finance. The plan identifies TCFD-aligned disclosure and inclusion of environmental consideration in investment decisions among the components of the plan.</p> <p>The plan identifies "optimisation of natural resources consumption" as a desired outcome, but it does not specifically identify forests, water, or biodiversity as priorities.</p>	Late 2021	x	-	-
3	Sustainable and Responsible Investment (SRI) Sukuk Framework	SC	SC	<p>The SRI Sukuk Framework facilitates the creation of a sustainable finance ecosystem for SRI investors and issuers. The framework was introduced in concert with Malaysia's position as a centre for Islamic finance. The framework includes requirements on disclosure, independent monitoring, and reporting.</p>	2014	x	x	x

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4	Value-based Intermediation and Investment Impact Assessment Framework (VBIAF)	BNM	BNM	<p>The VBIAF provides an impact-based risk management system designed to help Islamic financial institutions in assessing the financing and investment activities, incorporating environmental, social and governance ESG considerations in their risk management systems.</p> <p>Current sectoral guidelines cover palm oil; renewable energy; and energy efficiency. Additional guidelines on oil and gas; manufacturing; and construction and infrastructure are expected to be launched in late 2021.</p>	2019	x	x	x
5	Sustainable and Responsible Investment (SRI) roadmap for the Malaysian capital market	SC	SC	<p>Identifies priorities for growing the sustainable finance market:</p> <ul style="list-style-type: none"> ▼ Widening the range of sustainable finance products (including sharia-compliant products) ▼ Increasing the investor base ▼ Developing the issuer base ▼ Instilling a strong governance culture ▼ Designing suitable information architecture 	2019	x	x	x (The roadmap mentions land use, but not forest specifically)
6	Socially Responsible Investment (SRI) taxonomy	SC	SC	<p>Building on the SRI Roadmap launched in 2019, the Securities Commission is developing an SRI taxonomy alongside BNM and other members of the JC3. A draft of the taxonomy is expected to be released for public consultation in October 2021⁸.</p>	Likely 2022	Unknown	Unknown	Unknown
7	Bursa sustainability requirements	BM	BM	<p>Issuers are required to release a narrative sustainability statement on management of material environmental, economic, and social issues. BM provides a sustainability reporting guide and toolkits.</p>	2019	x	x	x

Nb: This is not an exhaustive list of actors but key regulatory and policy initiatives in Malaysia

8. The Star (2021): SC plans to release guides on SRI Taxonomy by year-end.

ANALYSIS (INCLUDING GOVERNANCE CHALLENGES)

The posture of Malaysian regulators leans toward voluntary consideration of environmental criteria among FIs. As such, there are no environmental criteria in supervisory or prudential regulation, although non-binding documents like the recently updated Malaysian Code of Corporate Governance encourage companies to consider climate risk. JC3 is developing further guidance on risk management and scenario analysis.

Through JC3, the Malaysian government has sent a clear message that the country intends to become a hub for sustainable and Islamic finance. BNM Governor Nor Shamsiah recently announced that the central bank would soon consider climate issues within the context of capital requirements and supervisory assessments. The governor also reported that BNM has set up a financial stability committee that would put in place a four-year plan for climate stress testing at the counterparty level.

Bursa Malaysia (BM) has required listed companies to disclose on sustainability since 2016. The current rules require listed companies to provide a narrative sustainability statement that covers management of material economic, environmental, and social (EES) risks and opportunities. Issuers listed on the Main Market must also provide details on governance structure and risk management processes relevant to EES risks deemed material. BM has noted that while compliance rates are high, the quality of the data reported is considered low. To address this, BM is undertaking a review of its disclosure requirements and will likely specify climate-related metrics. The review is expected to be completed by the end of 2021.

While environmental reporting is not yet required, Governor Nor Shamsiah has indicated that BNM will announce plans for mandatory climate-related disclosure for FIs by the end of the year.

This builds on JC3's previously stated objective to support the voluntary release of climate-related disclosures consistent with the recommendations of the TCFD. JC3 plans to drive adoption by "contextualizing the recommendations to the Malaysian economy and financial system" and through capacity building for both FIs and corporations⁹. A JC3 stock take found that local FIs lag significantly behind their foreign peers which also operate in Malaysia. To address this gap, JC3 is currently preparing an application guide for TCFD disclosure. The guide will be released for public consultation in October.

Malaysia's Climate Change and Principles-based Taxonomy was published in early 2021. The taxonomy was developed by BNM and will be implemented by JC3 in the coming years. As a principles-based taxonomy, it does not provide quantitative thresholds (as in the EU taxonomy) or qualitative descriptions of qualifying activities (as in China's). It does, however, have examples of activities that support mitigation and adaptation. FIs are referred to the VBIAF sectoral guidelines, including on palm oil, for additional guidance on identifying sustainable activities. The taxonomy also requires evaluation at both the transaction and company level. It takes into consideration any remedial measures and allows for transition financing for companies undertaking such measures.

The way forward

Linking the VBIAF and the TCFD

With the growth of Islamic finance comes the increasing importance of understanding the alignment between the VBIAF requirements and the TCFD recommendations and engaging with Islamic financial institutions to raise awareness of the TCFD. Further research could assess the preparedness of Islamic financial institutions to integrate the TCFD into the VBIAF and develop roadmaps to overcome identified challenges.

Capacity building

JC3 has prioritized building capacity among FIs and corporations with respect to disclosure, risk management, and scenario analysis. This priority should include wider dissemination of the VBIAF sectoral guidelines on palm oil so as to curtail financing of destructive palm oil production. Other priorities include developing relevant guidance and encouraging the voluntary implementation of the TCFD. Building capacity in these areas could increase the perceived reasonableness of instituting mandatory disclosure.

9. BNM (2021): Joint Statement by Bank Negara Malaysia and Securities Commission Malaysia: Towards Greening the Financial Sector

Addressing data gaps

JC3 has a workstream dedicated to identifying relevant climate data and sources to bridge data gaps. This focus should be expanded to explicitly identify forests-related metrics and indicators. Regulators acknowledge the importance of quality data in risk management and scenario analysis. BNM also identified quality data as key to ensuring credible, consistent implementation of the CCPT. The achievement of this objective will be closely linked to building capacity in environmental reporting.

Developing roadmaps and agendas

Little official information about Malaysian Climate Action Council (MYCAC) has been released publicly, but media reports indicated that it is chaired by the Prime Minister and operates with the mission of coordinating and facilitating efforts to meet Malaysia's commitments under the Paris Agreement. In April 2021, MYCAC announced six priorities, including the establishment of an emissions trading scheme and the development of a green recovery plan¹⁰. Similarly, the Capital Markets Plan 3 by the SC will outline a more expansive sustainability agenda. Both MYCAC's recovery plan and SC's new master plan should adequately address climate and deforestation, identifying how FIs can leverage their value chains to drive sustainability and reporting. CDP should continue to engage with Malaysian stakeholders so as to better understand – and ultimately support – MYCAC's work.

Taxonomy implementation

The CCPT has already begun to influence the development of other national and regional taxonomies. Singapore's Green Financial Industry Taskforce references the CCPT in its own consultation on Singapore's proposed taxonomy. Representatives from BNM, which developed the CCPT, sits alongside the Monetary Authority of Singapore on the ASEAN Taxonomy Board, which is charged with developing a taxonomy for the bloc.

The CCPT provides for transition financing, which will remain a key priority in Malaysia as more companies begin to seek funding in order to pivot toward greater sustainability, in many cases requiring instruments like sustainability-linked loans, bonds and sukus. In addition to building capacity in the areas laid out above, these companies will require support with decarbonization and moving away from practices driving deforestation. CDP could play a role in tracking progress among recipients of transition funding.

Likewise, the announced SRI taxonomy will have to centre climate and forests impacts in its classification system, and provide adequate detail and training to enable FIs to allocate capital toward sustainable activities.

While it is unclear how the CCPT and Singapore's taxonomy will intersect with an ASEAN taxonomy, the CCPT could be particularly influential given its flexibility and approach to transition-related activities. This flexibility would be especially important in a region with diverse economies and income levels. Over time, however, the taxonomy may require greater stringency as the Malaysian and ASEAN economies progress toward a low-carbon economy. Through this process, regulators, FIs, and corporations will likely require support from outside organizations like CDP in the implementation and evolution of both the CCPT and the ASEAN taxonomy.

10. Bernama (2021): Tuan Ibrahim: Govt's approach to climate change issues outlined in MyCAC.

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About CDP

CDP is a global non-profit that drives companies and governments to reduce their greenhouse gas emissions, safeguard water resources and protect forests. Voted number one climate research provider by investors and working with institutional investors with assets of over US\$106 trillion, we leverage investor and buyer power to motivate companies to disclose and manage their environmental impacts. Over 9,600 companies with over 50% of global market capitalization disclosed environmental data through CDP in 2020. This is in addition to the hundreds of cities, states and regions who disclosed, making CDP's platform one of the richest sources of information globally on how companies and governments are driving environmental change. CDP is a founding member of the We Mean Business Coalition.

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