

Greening the financial system - from ambition to action

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As one of the mega-diverse countries in the world, a lot of weight falls on Malaysia's shoulders in the fight against climate change and biodiversity loss. Malaysia has experienced drought, landslides, storm surges, and the large majority of its climate hazards losses are attributable to flooding with estimated losses of around US\$1.3 billion.

Climate change and nature-related loss are key drivers of financial risks, impacting price and market stability, and should therefore be tackled as an integral part of central banking and financial supervisory mandates and activities.

For financial regulators to benchmark their policies against emerging global practices, WWF has been conducting an annual Sustainable Financial Regulations and Central Bank Activities (SUSREG) assessment encompassing the banking and insurance sector.

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This year's SUSREG assessment, launched after the UN Biodiversity Conference (COP15), covers 44 jurisdictions accounting for over 88% of global GDP. Malaysia has demonstrated considerable progress in greening financial regulations. A number of sustainable finance guidelines have been issued covering environmental and social (E&S) risks, including the Value-based Intermediation Financing and Investment Impact Framework (VBIAF) sectoral guides.

Financial institutions are expected to manage climate-related risks based on the Climate Risk Management and Scenario Analysis guidance issued by Bank Negara Malaysia (BNM). One key recommendation from SUSREG is for financial regulators to set prudential rules to limit financial institutions' exposure and raise capital requirements and systemic risk buffers on high risk activities. This is crucial to provide protection against the build-up of systemic E&S risk and foster long-term financial stability.

Financial institutions in Malaysia are also expected to provide disclosures based on the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations and the Climate Change and Principle-based Taxonomy (CCPT). Initiatives by the Joint Committee on Climate Change (JC3) on the development of a data catalogue to map available climate data sources is also underway.

Enhanced disclosure and data availability will result in greater transparency and harmonisation that will facilitate better decision making and risk management. A Bank Negara Malaysia and the World Bank study found that 54% of the commercial loans portfolio are exposed to sectors that highly depend on ecosystem services. With increased nature-related financial risks, financial institutions should build capacity to integrate nature into decision making in accordance with the forthcoming Taskforce on Nature-related Financial Disclosures (TNFD) framework. Managing this exposure would also require enhanced deforestation and conversion free commitments from financial institutions and businesses.

A risk-based classification framework (taxonomy) for sectors and assets exposed to biodiversity loss may facilitate the reallocation of capital flows from biodiversity-negative to -positive projects. Momentum is building among central banks in integrating E&S considerations into monetary policy. The European Central Bank is gradually decarbonising its corporate bond holdings by tilting towards issuers with better climate performance. Banque de France is evaluating the creditworthiness of corporations as part of its collateral framework, while De Nederlandsche Bank is integrating ESG considerations in managing its own funds and foreign reserves portfolios. Over time, more central banks in emerging markets will likely follow suit.

In this respect, BNM's active role in the Central Bank & Supervisors Network for Greening the Financial System (NGFS) and various global platforms is a driving force in which good regulatory and supervisory practices can be further amplified. Achieving a climate safe and nature positive economy calls for an integrated, whole-of-society approach. Central banks and financial supervisors are expected to accelerate the full mobilisation of their monetary

policy, regulatory and prudential tools to support a timely and orderly transition. Setting a roadmap along with a credible transition plan in the financial system would support Malaysia's net zero aspiration and commitment towards becoming a sustainability first nation.

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