

Accelerating ESG integration in Malaysian banks

PwC Malaysia's 2021 survey on ESG
readiness in the Malaysian banking sector

Introduction

The COVID-19 pandemic has undoubtedly heightened the focus on sustainability, with significant implications on the financial services sector among other industries powering the Malaysian economy.

A collective response to address sustainability risks has now become crucial. The financial services sector, as a key enabler of the economy, plays a critical role in ensuring holistic efforts toward sustainability are achieved.

As such, embedding Environmental, Social and Governance (ESG) principles into the core strategy of financial institutions is a key focus. In driving this forward, Bank Negara Malaysia (BNM) is forging ahead with various initiatives to advance the sustainability agenda among financial institutions.

From 2021 onwards, BNM will be integrating climate-related risk considerations in their regulatory and supervisory expectations, as well as macroeconomic and financial stability assessments*.

How are Malaysian banks responding to these initiatives?

Several critical questions confront the banking sector as they embark on embedding sustainable practices. In particular, what is needed in building a resilient financial system against social, climate and environmental-related risks. And beyond that, what must be done to best facilitate orderly transition to a low-carbon economy.



PwC Malaysia's inaugural survey on ESG readiness in the Malaysian banking sector explores these questions. A total of 14 Malaysian banks shared their views during this July - August 2021 survey exercise.

This report provides key survey findings and insights into the level of ESG adoption and challenges faced by Malaysian banks in navigating this disruptive environment.

Highly challenging as it may be, embedding sustainability presents a golden opportunity for banks to reinvent themselves. We hope the perspectives featured in this report will be useful to help banks seize opportunities and realise possibilities as a sustainable financier.

*Source: <https://www.bnm.gov.my/climatechange>

ESG journey for Malaysian banks

Malaysian banks are pressing the pedal in their ESG journey but the level of ESG integration into the business varies across banks.

71%

say they have considered Climate Change risks.

86%

say they have considered other Environmental risks, such as waste management and biodiversity protection.

100%

say they have considered Social¹ and Governance² priorities.



¹ Social priorities are including but not limited to human rights and fair labour standards, diversity and inclusion, workspace health and safety, etc.

² Governance priorities are including but not limited to company duties and responsibilities, transparency and disclosures, accountability, etc.

Adoption of ESG frameworks in Malaysian banks

To-date, a number of ESG-related frameworks have been issued to guide banks on integrating sustainable practices into their businesses. How are banks progressing in adopting the CCPT, VBIAF and TCFD in particular?

21% say they have embedded **all three frameworks** into their organisations.



While the rest are taking an incremental approach...

Climate Change and Principle-based Taxonomy (CCPT)³

50%
have adopted CCPT.

Remaining 50% of banks plan to adopt in the next 2 years.

Value-based Intermediation Assessment Framework (VBIAF)³

57%
have adopted VBIAF.

36% plan to adopt in the next 2 years

Task Force on Climate-related Financial Disclosures (TCFD)

64%
plan to adopt TCFD in the next 2 years.

This response is amidst plans by the Joint Committee on Climate Change (JC3)⁴ to develop guidelines by end-2021 for:

- Climate risk management and scenario analysis
- TCFD-aligned disclosures

³ CCPT and VBIAF are issued by Bank Negara Malaysia on 30 April 2021 and 1 November 2019 respectively.

⁴ JC3 is a [platform](#), co-chaired by Bank Negara Malaysia and Securities Commissions, to pursue collaborative actions for building climate resilience within the Malaysian financial sector

A closer look at banks' navigation of the CCPT

Taking a closer look at the application of five Guiding Principles (GPs) of the Climate Change and Principle-based Taxonomy (CCPT) by banks, we found that:

70%

of banks which have adopted CCPT say the most challenging principles are **GP3: No significant harm to the environment** and **GP4: Remedial measures to transition**. This is due to the need for a holistic assessment of a customer's overall business model to comply with both principles.

The common implementation challenges encountered by banks when adopting the Guiding Principles are:



Absence of client data/information (including poor data quality)



Lack of ESG expertise



Challenges in translating principles-based guidelines into practice



Lack of awareness among stakeholders



Difficulty in measuring indirect environmental impact



No standardised disclosure requirements



A closer look at banks' navigation of the CCPT (cont'd)

Banks are encouraged to apply the CCPT's Guiding Principles to categorise a customer's portfolio into one of three sustainability categories - Climate Supporting, Transitioning, and Watchlist⁵.

How are Malaysian banks responding to this?

43% of respondents have yet to categorise their customer portfolio.

71% intend to work together with their customers (e.g. via a nurturing/partnership approach) to improve their climate change readiness if they fall under the Watchlist category.

⁵ Climate supporting refers to economic activities with positive impacts on climate change, and causing no significant harm to the environment. Transitioning refers to economic activities causing significant harm to the environment but remedial measures taken to reduce harm. Watchlist refers economic activities causing significant harm to the environment and no remedial measures taken to reduce harm.

⁶ [Joint statement by Bank Negara Malaysia and Securities Commission Malaysia advancing the financial sector's response to climate risk](#)

JC3⁶ has set up the following initiatives in August 2021 to strengthen the financial sector's capacity in managing climate-related risks:



Established a CCPT Implementation Group.



12 JC3 members have committed to early adoption of the CCPT from July 2022.



Expected to publish reference guides on climate risk management and scenario analysis, and climate-related disclosures by Q4 2021.



Established a sub-committee on bridging data gaps.

How are Malaysian banks operationalising ESG?

How are banks allocating responsibilities for ESG risks within their organisations?

> 90%

say they have assigned a department to operationalise ESG.



Banks are making progress in establishing governance and oversight over ESG risks. Our survey results show that banks have allocated responsibilities for ESG risks to a specific department. Notably, several banks have established a dedicated department for Sustainability.

Top three departments tasked to oversee ESG risks are:



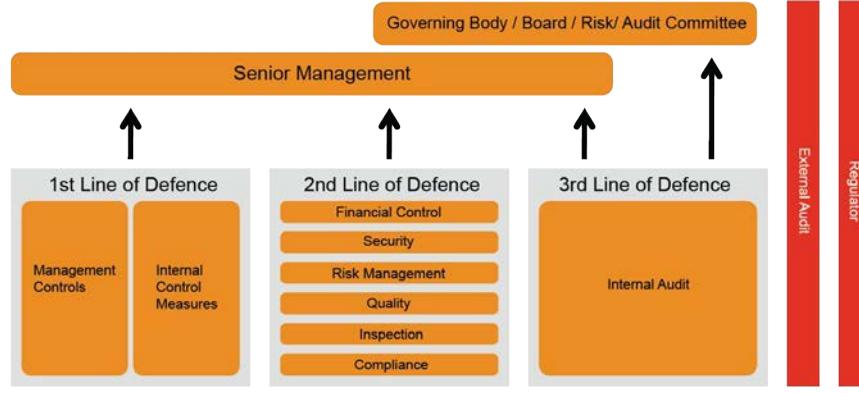
While progress is commendable, more needs to be done. Boards have a critical role to play in shaping the strategic vision for banks' ESG risk programmes. The [Malaysian Code on Corporate Governance \(MCCG\) 2021](#)⁷ and [World Economic Forum \(WEF\) report](#)⁸ offer best practices and guidance for boards to strengthen oversight and integrate sustainability considerations into strategy and operations.

⁷ Trust in Resilience: Cracking the code on trust for boards (article by PwC Malaysia's Andrew Chan and Dominic Chegne), The Edge Malaysia, 2021

⁸ WEF (in collaboration with PwC): How to Set Up Effective Climate Governance on Corporate Boards, 2019

How are Malaysian banks operationalising ESG? (cont'd)

The Three Lines of Defence Model



Adapted from ECIIA/FERMA

Guidance on the 8th EU Company Law Directive, article 41

Apart from the critical role of Boards in driving ESG response, effective sustainability governance should cascade through all three lines of defence⁹ within banks.

Roles and responsibilities for managing sustainability needs to be clearly defined to demonstrate where accountability for risk management resides across each line.

Best practices of sustainability governance¹⁰



⁹ IIA Position Paper: The Three Lines of Defense in Effective Risk Management and Control

¹⁰ Source: Best practices of sustainability governance from [Malaysian Code on Corporate Governance \(MCCG\) 2021](#), [Bursa Malaysia Sustainability Disclosure Review 2020](#), and [World Economic Forum \(WEF\) report](#)

How are Malaysian banks building capability and capacity?

To enable greater effectiveness in sustainability governance, ESG skills need to be on par with industry developments. Our survey shows that banks have demonstrated commitment to build capability and capacity within their organisations.



Boards

The board's understanding and oversight of their organisation's approach to managing ESG risks are key to embedding effective governance.

Boards should also look out for their own professional development needs to demonstrate board compliance and competencies effectively in this fast evolving landscape.

93%

Board-level training has been conducted or is being planned.



Workforce

Investing in organisation-wide upskilling is crucial, be it through employee awareness workshops, training or lifelong learning courses in sustainability for employees in various roles/levels.



Specialists

Where specialised skills are not available in-house, there are efforts to hire ESG subject matter specialists to fill the gaps.

50%

say ESG subject matter specialists have been recruited.

How are Malaysian banks measuring ESG risks?

The majority of banks indicate that initial analysis has been undertaken to understand the impact of climate risk on their business models. However, this analysis has yet to be translated into risk assessments.



86%

expect the greatest impact of ESG risks will be on credit risk and lending processes.

In applying ratings to measure ESG risks,



57% say they would rely on **internal** ratings.



29% say they would rely on **external** ratings.

What stage are banks at in defining metrics to monitor progress against overall business strategy and risk appetite?

50%



have not begun this journey.

29%

are in the midst of this journey.

21%

have defined metrics.

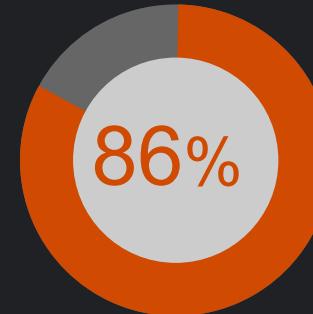
This observation is similar to a [2020 PwC UK survey¹¹](#) on the banking sector, where gathering accurate, useful data as part of the banks' risk management activities was a critical challenge. In the UK context, this was particularly so in the selection of appropriate metrics to monitor risks.

¹¹ [Rising to the challenge: climate risk in the UK banking sector, October 2020, Pg 28](#)

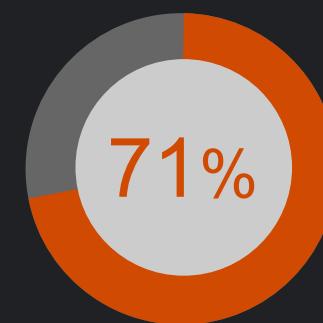
How are Malaysian banks measuring ESG risks? (cont'd)



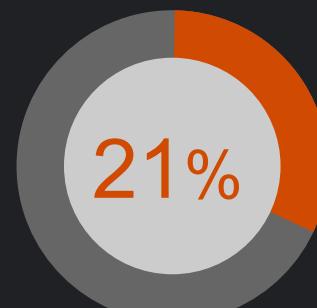
What plans do banks have to gather useful and accurate data for analysis?



plan to obtain data directly from their customers.



plan to use publicly available data and data provided by ESG specialist companies.



have not considered or analysed data sources needed.

What are challenges ahead and mitigation measures for Malaysian banks?

Given knowledge and data challenges at the initial stages of ESG risk identification and management, there is an urgent need to build strong foundations.

Top 3 challenges of embedding ESG factors into risk assessments:



86%

Low quality of customers' disclosures and ESG awareness.



71%

Absence of/ limited access to counterparty ESG data.



64%

Lack of knowledge and competences in the banks.



Several banks opine that having a common globally aligned framework and detailed disclosure requirements would be helpful in implementing ESG initiatives

36%

cite that having introduction of detailed ESG disclosure requirements would be useful.

29%

share that having a globally aligned framework and uniform interpretation of rules would be useful.

Sentiments of Malaysian banks show that there is appreciation for more detailed ESG disclosure requirements, although the majority have yet to deliberate over the need for a globally aligned framework. In comparison, 76% of PwC UK's survey¹² respondents are focussed on the need for establishing a global regulatory framework to manage climate risks.

¹² [Rising to the challenge: climate risk in the UK banking sector, October 2020, Pg. 34](#)

The way forward for Malaysian banks



1 | ESG strategy and alignment to corporate strategy

Consider a strategic approach to climate risk management by setting a science-based target or Net Zero strategy which is aligned to the overall corporate strategy of your bank, whilst considering the business opportunities created by climate change.

It is also critical that the board leads the way in shaping a strategic vision for the bank's climate risk programmes.



2 | Managing ESG risks

Banks should establish an ESG risk management framework, which is comparable to the established frameworks for financial risks, whilst also accounting for and reporting to the Board for ESG risk specific nuances where necessary.



4 | Culture & Capacity building

Investing in upskilling and capacity building programmes is critical, but more importantly, ensure that it aligns with your vision of the culture, capabilities, knowledge and competencies that your workforce should have.



3 | Credit assessment

Banks should consider incorporating ESG factors into risk rating models and frameworks to make credit risk appraisal decisions which are aligned to the bank's overall strategy.



5 | Addressing data gaps

Identify reliable internal and external data sources to accurately reflect your exposure to climate risk, in order to facilitate robust risk monitoring and risk management.

Supporting banks on the Sustainability journey



PwC's Academy Sustainability Learning Series

By specialists, for specialists

Delivered by our subject matter experts, we offer an array of ESG-related topics. The following is an example of topics tailored to specific needs. Speak to one of our contacts in the next page to craft topics that suit you.

- Sustainability awareness
- Net Zero and GHG emissions
- ESG risk assessment
- Sustainable Development Goals (SDGs)

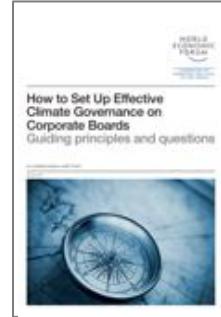
Global Reporting Initiative (GRI) training



PwC is a GRI Certified Training Partner since 2012 and is amongst the first to launch our sustainability report to GRI G4 Standards.

We offer a 2-day workshop that help participants to understand and coordinate the GRI sustainability reporting process.

Global ESG Thought Leadership



How to Set Up Effective Climate Governance on Corporate Boards



Integrating Natural Capital in Risk Assessments.



Linking executive pay to ESG goals



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