Asia Investor Group on Climate Change (AIGCC)

Submission to:

Bank Negara Malaysia Climate Change and Principle-based Taxonomy Discussion Paper

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Re: Discussion Paper on Climate Change and Principle-based Taxonomy

The Asia Investor Group on Climate Change (AIGCC) welcomes the opportunity to respond to public consultation on the Discussion Paper on Climate Change and Principle-based Taxonomy by Bank Negara Malaysia.

AIGCC members include 38 Asian and international institutional investors active in the region with over US$6 trillion funds under management, along with members of the investment community focused on the impacts of climate and energy issues.

AIGCC is also the Asia partner organisation of the Global Investor Coalition on Climate Change (GIC)[1], a coalition of four regional investor groups working collaboratively on global climate initiatives and engaging with members in our local markets to implement investor action on climate change.

AIGCC members are invested across Asian economies and are part owners of many of Asia's large companies. As managers of retirement savings and pooled investments we are concerned with the evident and increasing impacts of climate change on the global and Asian economies and the flow through impacts for investment returns.

[1] The four partner organisations are AIGCC (Asia), with 36 members and over US$5trn AUM), Ceres (North America), with 163 members and US$25.4trn AUM, Investor Group on Climate Change (Australia/NZ), with 70 members and over A$2trn AUM and the Institutional Investor Group on Climate Change (Europe), with over 170 members and €23trn AUM. For details, please visit: https://globalinvestorcoalition.org/

Overall comments on the consultation

In recent years, we have witnessed a shift in how the Asian business and financial community views climate change and the need to reduce greenhouse gas (GHG) emissions. Climate change has moved from being seen primarily as an environmental issue to being understood as a financial risk. Whether physical, regulatory or market-driven, climate change has financial implications for business and investors and GHG emissions have a bottom line impact.

As the demand for low carbon investments increases globally, investors are looking for greater clarity and guidance to identify investment opportunities that contribute to climate change mitigation and we welcome the efforts of Bank Negara Malaysia and the Securities Commission of Malaysia to enhance the standardisation and comparability of sustainable investment assets and underlying economic activities through a principle based taxonomy.

We are encouraged by the recommendations outlined in the Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market(2019), which identifies the need for a "taxonomy that is aligned to global standards creates a uniform and harmonised classification system that serves as a useful reference point for issuers, market practitioners, investors and other stakeholders both domestic and international."

AIGCC response to integration of climate-related risks for Supervised Institutions

We welcome the guidance provided by Bank Negara Malaysia in identifying climate change as a material source of risk that could pose threats to financial stability. We support the expectation on Supervised Institutions (banks, insurers/reinsurers, development finance institutions) "to integrate climate-related risks and considerations into their business strategies and risk management practices", by:

- Enhancing governance, oversight and organisational structure to consider climate change factors;
- Increasing awareness and understanding, build competencies and capabilities to integrate climate-related risks into the existing management framework; and
- Promoting transparency through voluntary disclosure of climate-related risks in line with the TCFD recommendations.

With respect to enhanced governance and oversight of material climate issues, we encourage Board-level oversight of climate related impacts and reference to sector specific guides such as the GIC Sector Reports and the TCFD Implementation Guide developed by The Climate Disclosure Standards Board (CDSB) and the Sustainability Accounting Standards Board (SASB), to determine the materiality of climate impacts at a sectoral level.

As a member organisation with a mandate to increase the awareness and understanding of Asian asset owners and managers on the integration of climate risks and opportunities in the investment process, we stand available to support investors and related financial stakeholders in Malaysia to share knowledge and best-practices at a regional level through organising C-suite roundtables, workshops and webinars to build competencies in this regard.

On promoting transparency and disclosure of climate-related risks, the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations has been widely adopted and is a recommended reference for issuers embarking on the journey of climate-risk disclosure. In line with the TCFD, we encourage issuers to review and assess the impact of climate-related risks which is broadly divided into transition and physical risks. Issuers are also recommended to consider longer-term strategies and disclose transition plans and emissions reduction targets including opportunities to allocate capital to lower-carbon economic activities and specific measures across the value chain to build resilience against climate change effects. Ultimately, issuers are encouraged to provide decision-useful information on financial implications associated with climate change.

AIGCC response to Assessment of Economic Activities

We welcome the initial proposal for a classification system to promote the transition towards a low carbon and climate resilient economy, by "incentivising transitions, supporting economic activities in low-carbon sectors and facilitating decarbonisation of existing industries". Given the guidance for Supervised Institutions to assess an economic activity and its impact to the broader environment based on 5 Guiding Principles, we offer comments on the principles below in turn:

Guiding Principle 1: Climate Change Mitigation

The objective of climate change mitigation to reduce GHG emissions in the atmosphere is clear at face value, and the specific activities noted that either avoid GHG emissions; reduce GHG emissions; or enable others to avoid or reduce GHG emissions, including renewable energy power generation, optimising energy consumption (energy efficiency), low carbon mobility, and green buildings provide an easily understood list of what could be broadly classified as substantially contributing to climate mitigation. However, an important metric for assessing whether an activity substantially contributes to climate mitigation is whether an activity is consistent with medium and long term climate goals, and associated emissions reduction targets, as outlined in EU taxonomy. We would encourage the inclusion of both medium and long term climate goals for Malaysia, as a major determinant of whether an activity can be deemed to substantially contribute to climate change mitigation. In particular, the list of "green and environmentally friendly economic activities" provided in Annex IV, includes some technologies associated with existing fossil fuel based energy sources, which would be excluded in the EU sustainable finance taxonomy:

a. *Energy efficiency - "boiler with energy efficient alternatives"*
b. *Manufacturing - carbon scrubber facilities and products for clean-up and treatment of exhaust gases from industrial plants*

We note the EU taxonomy specifically excludes activities deemed not to make a "substantial contribution to climate change mitigation" as per TR Article 14(2a), which states that "power generation activities that use solid fossil fuels are not considered environmentally sustainable economic activities" and Article 6(1.b), which states that improvement in energy efficiency in power generation activities referred to in Article 14(2a) cannot be considered to make a substantial contribution to climate change mitigation. Given these exclusions, we recommend that harmonization with existing global standards be considered and greater clarity on technical standards for eligibility are produced, with reference to the EU taxonomy and Malaysia's medium and long term climate goals.

Guiding Principle 2: Climate Change Adaptation

The objective of climate change adaptation to "increase resilience in order to withstand the negative physical effects of current and future climate change" and the definition of economic activity considered to meet climate change adaptation through "measures to increase own resilience or enable other economic activities to adapt to climate change" is noted. As per the EU taxonomy, a process to determine if an activity substantially contributes to adaptation and broader system's climate resilience is recommended. This would involve:

a) assessing the expected negative physical effects of climate change on the underlying economic activity that is the focus of resilience-building efforts, drawing on robust evidence and leveraging appropriate climate information; and

b) demonstrating how the economic activity will address the identified negative physical effects of climate change or will prevent an increase or shifting of these negative physical effects.

Guiding Principle 3: No Significant Harm to the Environment

Recognition that while an economic activity may contribute towards climate risk mitigation and adaptation, the overall business must also demonstrate adequate consideration of impacts on the wider ecosystem where the economic activity takes place is welcome. In addition to criteria related to pollution, ecosystem health and biodiversity and sustainable use of natural resources, some reference to avoiding a lock-in of assets that undermine long-term climate goals, considering the economic lifetime of those assets as per the EU Taxonomy, would strengthen this principle to avoid significant harm to the overall goals of the taxonomy. An example from mitigation could be the clear-felling of virgin forests for power infrastructure - undermining both mitigation and ecosystem resilience, or construction of energy intensive adaptation infrastructure that may undermine mitigation goals.

We note the guidance provided by the EU Sustainable Finance TEG, which states: "to be included in the Taxonomy, an economic activity must have criteria for the avoidance of significant harm to the other environmental objectives, including climate change mitigation". This means that activities which undermine climate change mitigation objectives could not count improvements in their resilience as Taxonomy-aligned. Adoption of a clear principle in this regard would minimize the risk that activities included in the taxonomy may undermine the overall objectives of the taxonomy itself to promote the transition towards a low carbon and climate resilient economy. A specific test case would be palm oil plantations, included in Appendix V, where some operational activities to replace fuel-based trucks to electric trucks is identified as aligned with GP 1, however the primary activity of palm oil plantations themselves, due to impacts on deforestation, may in fact be a significant contributor to the increase in greenhouse gas emissions. Further definition of terms for the inclusion of emissions intensive economic activities and expected transition trajectories would increase confidence in the taxonomy as per GP 4 below.

Guiding Principle 4 (GP4): Remedial efforts to promote transition

With respect to remedial efforts and improvement programmes undertaken by businesses towards the transition to low carbon and climate resilient economy, there could be further clarification of what types of activities could be included under this principle, as being assessed to “indirectly contribute to climate change mitigation and adaptation”. Further definition of transition activities, where low-carbon technologies may not be readily available, and the specific criteria for support in such circumstances, would increase confidence in the efficacy of activities included under this principle. This could refer to the definition of “transition activities” under Article 6(1a) of the EU taxonomy.

Guiding Principle 5 (GP5): Prohibited activities

The principle requiring supervised institutions to verify and ensure that economic activities are not illegal and do not contravene environmental laws is welcome. In addition to compliance with local laws, reference to international minimum standards and safeguards, as introduced in the EU taxonomy regulations, would substantially strengthen this principle. The European Parliament and the Council established that for an economic activity to be Taxonomy-aligned, the activity should be carried out “in alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the International Labour Organisation’s (‘ILO’) declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions and the International Bill of Human Rights”.

AIGCC response to External Certification and Verification

We acknowledge that the current paper provides that supervised institutions can leverage on third party verification or recognised certifications by local agencies, national authorities or globally accepted standards to provide assurance on environmentally sustainable practices. In order for the current principles to be uniformly applied, we see the need for more detailed technical assessment guidelines, and non-financial information disclosure standards, which would serve as a useful reference point for issuers, market practitioners, investors to determine to what extent particular economic activities contribute and how to attribute contributions at a business or portfolio level. We welcome Bank Negara Malaysia’s current efforts to establish “regulatory and supervisory expectations including disclosures by supervised institutions”, which would complement the taxonomy classification system.

AIGCC response to Classification System

Based on the guiding principles, we note the proposed classification of economic activities into six categories as per Table E, with reference to both the positive effects of economic activities in supporting climate change mitigation and adaptation and negative effects from harming the broader environment as a result of business activities undertaken and measures taken (or not taken) to reduce harmful practices.

This classification approach - which includes activities that substantially support mitigation or adaptation objectives but may cause harm to other environmental objectives, or do not directly support substantive mitigation or adaptation outcomes, may in part undermine the overall objectives of the initiative to support the "transition to a low carbon and climate resilient economy". While the early stages of transition should be acknowledged, inclusion of activities should be assessed on the basis of the original objective of "incentivising transitions, supporting economic activities in low-carbon sectors and facilitating decarbonisation of existing industries". If activities do not fit the above description or are assessed as not to substantially contribute, then those activities should not be classified as sustainable activities so as to avoid greenwashing and provide incentives to low carbon enterprise.

We note the guidance provided by the EU Sustainable Finance TEG, which states: "to be included in the Taxonomy, an economic activity must have criteria for the avoidance of significant harm to the other environmental objectives, including climate change mitigation". This means that activities which undermine climate change mitigation objectives could not count improvements in their resilience as Taxonomy-aligned.

In conclusion

A growing number of investors across markets in Asia are now actively looking for low-carbon investment opportunities that are underpinned by appropriate standards and transparent disclosures which would be assisted greatly by a taxonomy that enables the allocation of capital towards decarbonization objectives. We see the value in having robust discussions on standards between investors, issuers and regulatory authorities so that clear expectations are set and financing and investment decisions can be based on transparent, consistent and comparable metrics which maintain scientific integrity and accelerate the transition towards a low carbon and resilient economy.

We look forward to continuing to constructively engage further in recommendations to assist Bank Negara Malaysia and the Joint Committee on Climate Change in its efforts with regard to Climate Change and Principle Based Taxonomy and associated initiatives.

Yours sincerely,

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Director

Asia Investor Group on Climate Change