THE 3 PILLARS OF CORPORATE SUSTAINABILITY

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THE 3 PILLARS OF CORPORATE SUSTAINABILITY	
10.00am – 12.00pm	▪ **Opening & Introduction** ▪ **The Rise Of Sustainability and ESG Considerations & Their Impact On Business** ▪ **ESG Regulatory Focus In Malaysia** ▪ **Starting ESG Journey** ▪ **Q&A** ▪ **End of Program**

THE 3 PILLARS OF CORPORATE SUSTAINABILITY

The Concept of Sustainability

- Sustainability = meeting the needs of the present without compromising the ability of future generations to meet theirs.

- Broadly speaking, a company implements sustainable practices by reducing its consumption of limited resources, or finding alternative resources with lower environmental consequences.

- Sustainability has three main pillars: economic, environmental, and social. These three pillars are informally referred to as **people, planet, and profits.**

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Sustainable Development Goals (SDG)

Sustainable development goals can be applied to corporate policy in the business world as it encompasses 3 key areas: economic, environmental and social. Sustainable development requires that a company must contribute to economic growth, social progress and promote environmental sustainability.

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3 Pillars of Sustainability

Sustainable development is based on 3 fundamental pillars: social, economic and environmental.

- **The Environmental (or Planet) Pillar focuses on minimizing and eliminating greenhouse gas emissions and protecting the planet and its resources**. It includes areas such as green energy, waste management, eliminating toxic hazards, reuse or recycling of materials, and reducing the carbon emissions throughout the supply and demand chains.

- **The Social (or People) Pillar focuses on business practices that promote the health, safety and well-being of people,** including all stakeholders in a business: employees, customers, partners, and local communities. It includes creating organizations that are diverse, equitable, inclusive and just. It also includes employee welfare, fair wages, gender equality, worker and customer safety.

- **The Economic (or Profit) Pillar focuses on the financial viability, governance and transparency of a business.** It considers what business models, policies and practices businesses need to implement to survive and thrive as an economic entity that provides employment and economic opportunity for society.

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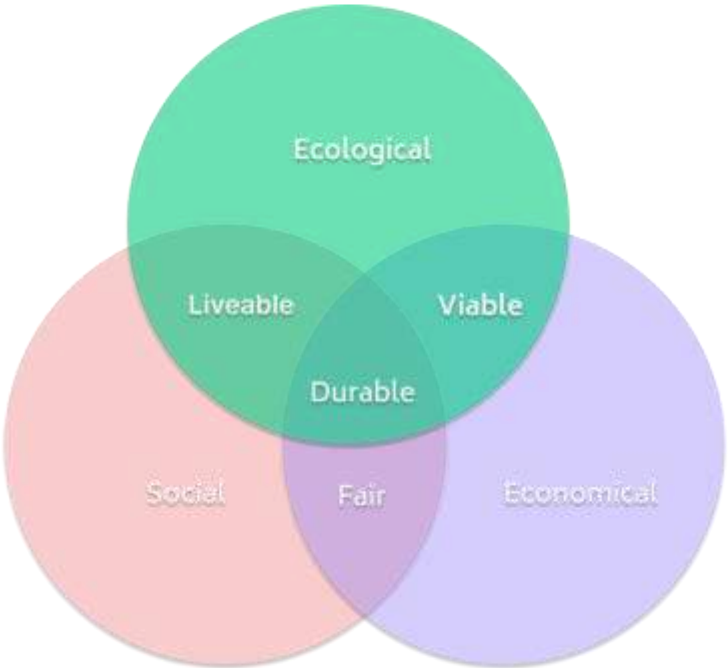
3Ps of Sustainability and The Triple Bottom Line Theory

The 3 components of sustainability are often referenced when discussing sustainable development, and are also known as the triple bottom line or the 3P's: **Planet People, Profit**. They must be equally considered and balanced to achieve sustainability.



The triple bottom line is a transformation framework for businesses **to help them move toward a regenerative and more sustainable future**. Tools within the triple bottom line help to measure, benchmark, set goals, improve, and eventually evolve toward more sustainable systems and models.

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Sustainability as a Business Concept

Sustainability is a **business approach** to creating long-term value by taking into consideration how a given organization operates in the ecological, social, and economic environments.

A corporate **sustainability strategy** will balance purpose and long-term growth with profit and balance the needs of employees, customers and society with the needs of shareholders.

Sustainability is built on the assumption that developing such strategies **fosters company longevity.**

Corporate sustainability often operates under ESG principles. **ESG maps almost exactly to the 3 pillars of sustainability.**

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Understanding the Concept and Relevance of ESG

- **ESG stands for Environmental, Social and Governance - three categories that enable businesses to measure the real sustainable and societal impact of their outputs.**
- **ESG, at its core, is a corporate governance and investment framework.**
- **Environmental, Social and Governance – are the three pillars of sustainability of any company.**
- **Companies that adopt ESG principles consider, measure, report and work to improve the environmental, social, and governance aspects of their business alongside its financial considerations.**
- ESG is one of the most notable trends in corporate governance, management, and investment of the past two decades.

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Understanding the Concept and Relevance of ESG

E = **Environmental criteria**, includes the energy a company takes in and the waste it discharges, the resources it needs, and the consequences for living beings as a result. Not least, E encompasses carbon emissions and climate change. Every company uses energy and resources; every company affects, and is affected by, the environment.

→ **Climate Change is the Most Pressing Issue**

S = Social criteria, addresses the relationships a company has and the reputation it fosters with people and institutions in the communities where it does business. S includes labour relations, diversity and inclusion. Every company operates within a broader, diverse society.

→ **"Social License" concept**

G = Governance criteria, the internal system of practices, controls, and procedures a company adopts in order to govern itself, make effective decisions, comply with the law, and meet the needs of external stakeholders. Every company, which is itself a legal creation, requires governance.

→ **The Guiding Force that Ties it All Together**

Source: Five ways that ESG creates value, McKinsey Quarterly, November, 2019

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Understanding the Concept and Relevance of ESG

- ESG factors cover a wide spectrum of issues that **traditionally are not part of financial analysis**, yet may have financial relevance and impacts.

- The integration of ESG factors into investment policies, processes and practices helps measure the **sustainability and ethicality** of a company.

- ESG issues are **important to businesses that prioritize sustainability**, and to investors looking for socially responsible investment opportunities.

- ESG issues are now becoming critical in **assessing how a company is run, how it serves the society, how it impacts the environment and how all of these factors cumulatively determine the company's overall performance.**

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Understanding the Concept and Relevance of ESG

ESG vs SDG

Sustainable Development Goals(SDG) are the 17 global goals set up by the United Nations in 2015 as part of Agenda 2030 that are intended to be achieved by 2030.

Companies mention what SDGs they are focussed on or have worked towards in their annual/sustainability reports.

These SDGs give a framework to companies to fulfil ESG requirements as each SDG entails E or S or G or a combination of two or all three together.

ESG vs CSR

Corporate Social Responsibility – is a self-imposed obligation towards the public, in general, and towards society, at large, of the companies.

Whilst ESG and CSR are both concerned with a company's impact on society and the environment, ESG takes on CSR and builds on it in a manner that takes it out of the realms of pure philanthropy, to a **concrete set of numbers which can be used and relied by investors and consumers** alike in understanding a company's philanthropic, social and internal governance practices.

ESG vs Sustainability

Although sustainability and ESG are almost similar, there's one main difference: **sustainability is vague, and ESG is specific and measurable.**

ESG looks at how the world impacts a company or investment, whereas sustainability focuses on how a company (or investment) impacts the world.

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The pace of ESG evolution is hectic – but companies need to understand the rationale and impact of such evolution

ESG began as a strategy used to make investment decisions. However, it has evolved such that ESG-related factors are now considered more broadly, including in government policies and corporate strategies.

Key drivers:

- **Investors are increasingly focusing on and publicly committing to evaluating their shareholdings based on ESG criteria.**
- Growing adoption of **ESG disclosures** and moving toward mandatory ESG disclosure
- **Activist shareholders** put pressure on companies to build a "green" reputation, exercising voting rights to push for greater ESG measures to be taken
- **Consumers and NGOs** may try to call for boycotts, or be the source of negative publicity through high-profile campaigning on climate change, modern slavery, respect for human rights and other ESG issues. They may also put pressure on regulators to intervene and investigate
- Need to improve, standardize, and audit ESG data

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Net Zero Commitments: PETRONAS & TNB

- PETRONAS aspires to achieve net zero carbon emissions by 2050, delivering clean energy and low carbon solutions to people globally.

PETRONAS: Net Zero Carbon Emissions by 2050

- Tenaga Nasional Berhad (TNB) announced its sustainability pathway with an aspiration to achieve net zero emissions by 2050, in a bold move towards decarbonisation and Renewable Energy (RE). This aspiration is underpinned by a commitment to reduce 35% of its emissions intensity as well as 50% of its coal generation capacity by 2035.

TNB: Net Zero Emissions Aspiration By 2050

Adopts sustainability pathway to reduce emission intensity by 35% and halve coal generation capacity by 2035

Net zero refers to the ***balance*** *between the amount of greenhouse gas produced and the amount removed from the atmosphere. We reach net zero when the amount we add is no more than the amount taken away. The term net zero is important because – for CO2 at least – this is the state at which global warming stops.*

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Khazanah & KWAP Prioritise ESG in Their Investments

Malaysia is aware that it needs to prioritise ESG criteria and to entrench the practice within the local business scene if it wishes to attract foreign investors from developed markets where ESG awareness is higher.

- **Khazanah considers ESG risks and opportunities as a part of its responsible investment approach throughout its investment process.**
- **Retirement Fund Inc (KWAP)** became a signatory of the Principles for Responsible Investment, a global investor initiative in partnership with UNEP Finance Initiative and UN Global Compact in 2018, integrating ESG factors into its investment decisions.-In July 2018, KWAP reported that the pension fund would set aside a total of RM3.8 billion for ESG investments.

Malaysia has been a signatory to the Paris Climate Accords, and intends to reduce its greenhouse gas emissions by 45% by 2030 relative to its emissions in 2005.

Malaysia is a supporter of the Task Force on Climate-related Financial Disclosures ("TCFD")

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PNB Sustainability Framework: Responsible Investing – Towards a Net Zero Future

- Net Zero Enterprise by 2025
- Net Zero Portfolio by 2050
- RM10 billion in New Green & Transition Assets by 2030

- Living wage in PNB by 2023
- Labour Rights Policy Paper by 2022
- 40% Women in PNB Leadership by 2025
- Balancing profitability and social investments

- Triple Bottom Line (TBL) Stewardship Model
- Transparency in voting
- TCFD-aligned Disclosure

EPF's evolution to be fully ESG compliant by 2030 and climate neutral by 2050

- Malaysia's largest pension fund, is one of the first Asian pension funds to publicly commit to sustainability when it announced its plan to have a fully compliant ESG portfolio by 2030 and a climate neutral portfolio (with net zero GHG emissions) by 2050.

- EPF's Sustainable Investment Policies are based on 4 guiding principles:
  - ✓ EPF will **integrate ESG** in its investment decision-making process
  - ✓ EPF recognises **stewardship** as a top priority.
  - ✓ EPF's ambition to become a regional leader in **sustainable investing** is aligned with its commitment to local and global sustainability goals.
  - ✓ to further EPF's successful transition towards being a **leader in sustainable investing**.

"It is imperative for institutional investors to play an effective stewardship role in driving and raising the standards of the ESG agenda in Malaysia's capital market.

As the largest fund in Malaysia, our aim is to bring along companies on our sustainability journey and to support the development of the country as a whole"

Amir Hamzah Azizan
CEO of EPF Malaysia

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ESG has now become a key strategic issue for businesses and companies.

ESG considerations are used to:

- ✓ **seek to understand and respond to critical environmental and societal challenges,**
- ✓ **ensure business resilience,**
- ✓ **protect access to capital in a changing market, and**
- ✓ **provide greater levels of corporate accountability and transparency.**

ESG RISKS

THE RISE OF SUSTAINABILITY AND ESG CONSIDERATIONS AND THEIR IMPACT ON BUSINESS

ESG Risks

- ESG risks **exist outside of a standard financial audit**, yet they are just as important to a company.
- Every business, regardless of size or industry, faces a variety of ESG concerns, some of which can result in financial or reputational harm.
- If not addressed swiftly and appropriately, ESG controversies can have massive negative impacts on company performance and survival.
- The cost of adaptation and mitigation can be huge, it is still a bargain when compared to the cost of doing nothing.

It is critical for businesses to recognize and mitigate the various types of risks that pose a threat to their company.

ESG Risks

From the corporate perspective, **ESG risks is not fundamentally different from managing any other risks** that the company may face.

To the extent that these risks have not yet been considered, the company is likely to need **new types of expertise, additional information channels, better analytical tools and comprehensive internal policies and practices** that are specifically designed to assessing the company’s ESG risks.

Source: Corporate governance and the management of ESG risks | OECD Business and Finance Outlook 2020 : Sustainable and Resilient Finance

Environmental Risks

ESG & Climate Risk Management

- **Climate risk refers to risk assessments based on formal analysis of the consequences, likelihoods and responses to the impacts of climate change and how societal constraints shape adaptation options.**

- Investors pay a lot of attention to a company's preparation assessment and capacity to forecast and respond to a variety of climate threats when evaluating its ESG profile.

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Companies can be exposed to physical risks.

Physical risk

Extreme weather and record temperatures are now recognized as events that can be predicted and factored into financial planning.

- Droughts, floods and wildfires are all examples of acute threats. Rising temperatures and an accelerated loss of biodiversity are all examples of chronic concerns.
- **Companies need to incorporate the consideration of physical risks across the enterprise risk framework** and audit committees will need to ask questions about how this is being done.
- Company disclosures related to climate change and the related financial risks and opportunities are increasingly gaining traction in corporate disclosures.

Physical risk is often undermanaged and underreported

Investors are looking for better and more qualitative and quantitative information about companies' exposure to physical climate change risks, how resilient their strategies are and what adaptation measures they're taking to ensure they can succeed and deliver on their strategy.

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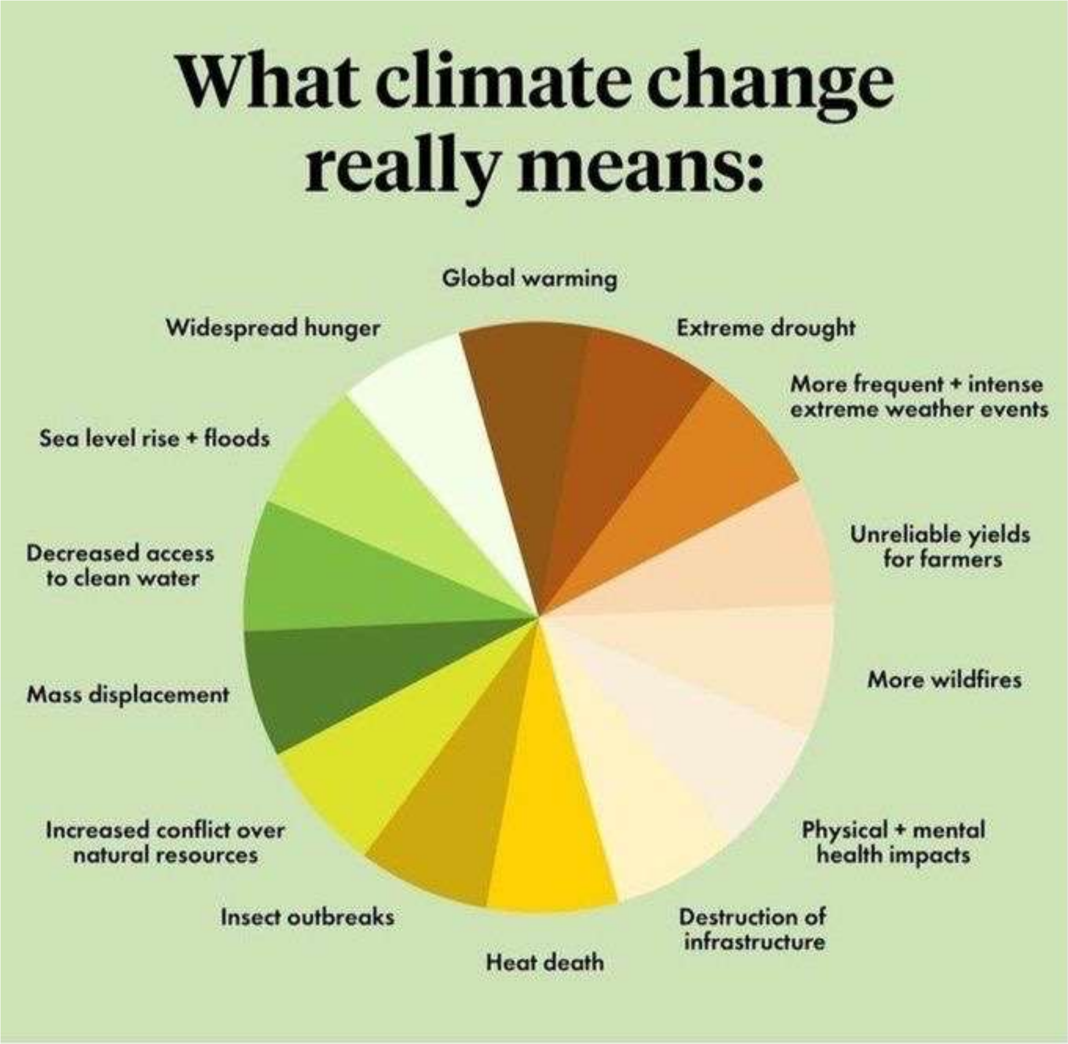
Companies can be exposed to physical risks.



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Companies can also be exposed to transition risks

- **Transition risk refers to the climate policies and laws shifting the global economy away from fossil fuels.**

- Policy and regulatory risks, technological risks, market risks, reputational hazards, and legal risks are all part of transition risk.

- These risks are intertwined, and they're often on investors' minds as they try to negotiate a more aggressive low-carbon agenda that might have capital and operational implications for their assets.

  - ✓ **Policy & Legal** (may include introduction of carbon offset initiatives or carbon tax/increased pricing on GHG emission, increased reporting/disclosure etc)
  - ✓ **Technology** (cost of transition to newer/lower emission technology)
  - ✓ **Market** (changing customer preference, increased cost due to changes in supply chain network)
  - ✓ **Reputation** (increased stakeholder expectation, stigmatization of certain industry such as mining/extractives)

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Social Risks

Social risks involve issues that are diverse, qualitative and often affect all company stakeholders simultaneously, from workers and customers to suppliers and local communities.

Maintaining healthy, positive, fair and ethical relationships with these stakeholders is critical to the long-term success of a company, especially if that business' success relies on public trust.

Types of social risk include:

- Diversity, equity and inclusion
- Wage equality
- Working and safety conditions
- Respect for human rights
- Community engagement
- Ethical supplier/vendor labour practices

Social issues tend to have an impact on all company stakeholders.

Social factors increasingly influence the availability of capital.

Governance Risks

G

Governance risk includes the risks related to an organization's ethical and legal management, the transparency and accuracy of company performance, and involvement in other ESG initiatives important to stakeholders.

Types of governance risk include matters related to the management of:

- Company integrity and ethics
- ESG initiative/regulation compliance (including emerging regulations)
- ESG disclosures
- Corruption/fraud prevention
- Executive remuneration
- Board structure, diversity and inclusivity
- Bribery and corruption
- Tax compliance

THE RISE OF SUSTAINABILITY AND ESG CONSIDERATIONS AND THEIR IMPACT ON BUSINESS

It is said that companies can utilise ESG as a moral compass in re-modelling their corporate strategies whilst exploring new business opportunities. Mainstreaming of ESG will reinforce organisational resilience, sustainability and long-term value creation.

Picture Credit: Getty Images

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Criticisms on ESG

As ESG has gone mainstream and gained support and traction, it has consistently encountered doubt and criticism as well*.

ESG is not desirable, because it is a distraction

ESG IS A SCAM!!!

ESG is not feasible because it is intrinsically too difficult

ESG is not measurable, at least to any practicable degree

Even when ESG can be measured, there is no meaningful relationship with financial performance

**Sources: https://www.mckinsey.com/capabilities/sustainability/our-insights/does-esg-really-matter-and-why*

COMMENTS & QUESTIONS

REGULATORY ASPECT OF ESG

"Just like other corporate governance principles, ESG practices are still a work in progress. It is a journey for Malaysia as mandatory sustainability reporting was only made compulsory in 2016 for large-cap companies".

Tan Sri Zarinah Anwar,
Chairman of Institute of Corporate Directors Malaysia,
The Malaysian Reserve,
August 27th, 2021

Malaysia's regulators are increasing their attention on ESG.

REGULATORY ASPECT OF ESG

ESG matters were traditionally considered outside the scope of fiduciary duty, with the board and management often, at best, considering it an ancillary topic under the ambit of corporate social responsibility, or at worst, taking an out-of-sight, out-of-mind approach.

REGULATORY ASPECT OF ESG

ESG From the perspective of the Malaysian Code on Corporate Governance 2021

MCCG 2021 highlights the urgent need for boards and senior management of public-listed companies to manage ESG risks and opportunities.

- Under the 2021 MCCG, the **board together with management are responsible for the sustainability governance in the company** including setting the company's sustainability strategies, priorities and targets.

- The 2021 MCCG clarifies the relationship between ESG and corporate governance where **integration of sustainability consideration is now required in corporate strategy, governance and decision-making** as sustainability and its underlying ESG issues are becoming mainstream/central to the ability of companies to create durable and sustainable value and maintain the confidence of their stakeholders.

Resilience of a company depends on its board taking a much more **holistic view** of the business coupled with proactive and effective measures to anticipate and address material ESG risks and opportunities.

REGULATORY ASPECT OF ESG

ESG From the perspective of the Malaysian Code on Corporate Governance 2021

Practice 4.1	Responsibility for oversight and strategic management of sustainability matters
Practice 4.2	Public disclosure as well as ongoing internal and external stakeholder engagement on the management of sustainability matters
Practice 4.3	Sustainability forms part and parcel of professional development and board skills matrix
Practice 4.4	Integration of sustainability in board and senior management performance evaluation and KPIs
Step Up 4.5	Identification of a designated management-level individual to strategically manage sustainability

Practice 4.1 lays the foundation for boards to orient themselves with what matters most for their company in terms of ESG oversight.

Practice 4.2 highlights the importance of public disclosure via sustainability reporting and a stakeholder-driven process in ESG communication.

Practice 4.3 highlights the importance for board members to have the sufficient understanding and knowledge of sustainability issues that are relevant to the company and its business, to discharge their role in ESG oversight effectively, including climate-related risks and opportunities.

Practice 4.4 discusses accountability and performance and that it is vital for companies to embed ESG in performance evaluations and if deemed suitable, link ESG performance to remuneration.

Practice 4.5 clarifies the role of Chief Sustainability Officer.

Corporate Governance Guide Pull-out I, Guidance on Board Leadership and Effectiveness

REGULATORY ASPECT OF ESG

ESG From the perspective of the Malaysian Code on Corporate Governance 2021

The MCCG 2021 requires companies to address sustainability risks and opportunities to support its long-term strategy and success.

Key Takeaways for Business on ESG-Related Items in MCCG 2021:

- **Enhanced Board's & Management's Roles:** Enhanced boards and management responsibilities to include specific expectations on determining the company's sustainability strategies, priorities and targets.

- **Sustainability Role in the Company:** A Sustainability Committee needs to be set up if sustainability issues are prevalent in the company. Alternatively, appoint a dedicated sustainability person in management. Consider skills sets and experience required to fill in the knowledge gap.

- **Board Composition & Skill Sets:** Ensure that the composition has members with knowledge of climate change issues relevant to the business and stakeholders. Get advice on matters requiring specialised expertise including on sustainability, legal, compliance etc. To manage current and emerging challenges, board's training need to be up-to-date.

- **ESG target setting/ performance targets:** Expect higher level of corporate disclosure with target setting, gap analysis etc. and independently assured. Board and management's performance evaluation framework to reflect their accountability and the evaluation results are to be shared with the company's shareholders.

REGULATORY ASPECT OF ESG

Securities Commission's Guidelines on Conduct of Directors of Listed Corporations

Chapter 5 of the Guidelines on Conduct of Directors of Listed Corporations and their Subsidiaries make reference to 'material sustainability risks'

Group Governance

- **5.01:** A listed corporation and its directors must ensure there is an adequate group wide framework for co-operation and communication between the listed corporation and its subsidiaries to enable it to discharge its responsibilities including oversight of group financial and non-financial performance, business strategy and priorities, risk management including **material sustainability risks**, and corporate governance policies and practices.
- **5.02:** A listed corporation and its directors must establish and ensure the group wide framework on corporate governance include a code of conduct and ethics, policies and procedures on anti-corruption, whistleblowing, managing conflict of interest, managing **material sustainability risks**, and board diversity including gender diversity.

REGULATORY ASPECT OF ESG

ESG from the perspective of Companies Act 2016

- Section 213 of the CA 2016 provides for two broad categories of duties that directors owe to their companies:
  - the fiduciary duty to act for a proper purpose and in good faith in the best interests of the company and; and
  - a duty of care, skill and diligence.
- **The Companies Act 2016 does not directly require the board to consider ESG factors in their business decisions. However, when ESG factors affect or intersect with the interests of the company, directors should consider them.**
- Our Companies Act 2016 is different from the UK Companies Act 2006 where there is a specific provision (Section 172(1)(d)), requiring directors to consider, among others, **interest of employees, the need to foster business relationships with suppliers, customers and the impacts of the company's operation on the community and environment** when promoting the success of the company for the benefit of its members as a whole.

Although Section 213 CA 2016 does not contain similar provision with that of the UK Companies Act 2006, directors cannot escape responsibility since similar requirement can still be drawn from Section 213 in respect of the duties owed by directors of Malaysian companies.

REGULATORY ASPECT OF ESG

ESG from the perspective of Companies Act 2016

- **Failure by directors to consider company's operations in relation to the causes and effects of climate change is a failure to consider material risks to the company.**
- **Failure to consider material risks may be construed as a failure by a director to exercise reasonable care, skill and diligence**, or a failure to act in good faith in the best interest of the company in breach of Section 213 of CA 2016.
- Regulators in Malaysia have strongly emphasised the need for directors to keep up with relevant and up-to-date developments including having a sufficient understanding of sustainability issues relevant to the business of the company, as well as climate-related risks and opportunities.

Directors risk acting in breach of their duties if they do not inform themselves of climate risks, incorporate a broader sustainability agenda in their companies' operating and decision-making processes and take the required steps to address these issues.

REGULATORY ASPECT OF ESG

BURSA MALAYSIA ENHANCES SUSTAINABILITY REPORTING FRAMEWORK WITH NEW CLIMATE CHANGE REPORTING

Main Market listed issuers will now be required to include the following disclosures in their Sustainability Statements:

- **Common sustainability matters**: a common set of prescribed sustainability matters and indicators that are deemed material for all listed issuers;
- **TCFD-aligned disclosures:** climate change-related disclosures that are aligned with Task Force on Climate-related Financial Disclosures ("TCFD") Recommendations;
- **Enhanced quantitative information**: at least three financial years' data for each reported indicator, corresponding targets (if any) as well as a summary of such data and corresponding performance target(s) in a prescribed format ;
- **Reviewed/Assured:** a statement on whether the Sustainability Statement has been reviewed internally by internal auditors or independently assured ("statement of assurance"); and
- **Transition Plan:** ACE Market listed corporations are now required to disclose a basic plan to transition towards a low carbon economy with regards to climate change reporting.

"The scale of the sustainability reporting enhancements that we have introduced today **sends a clear and unequivocal signal of Bursa Malaysia's ambition to be the leading exchange for ESG** in the region,"

Datuk Muhamad Umar Swift.
CEO, Bursa Malaysia

REGULATORY ASPECT OF ESG

Sustainability Governance is important

There have been increasing expectations from external stakeholders (e.g. institutional investors, lenders and customers) for companies to provide pertinent disclosures on their management of material sustainability matters. One critical component is the sustainability governance structure put in place to create a line of accountability for sustainability including the relevant governing bodies and/or functions established, division of roles and responsibilities as well as lines of reporting.

Listing Requirements

Paragraph 6.2, Practice Note 9, Main Market Listing Requirements[14]

In making the Sustainability Statement, a listed issuer must include disclosures on the following:

(a) the governance structure in place to manage the economic, environmental and social risks and opportunities ("sustainability matters");

Paragraph 6.2, Guidance Note 11, ACE Market Listing Requirements[15]

In making the Sustainability Statement, a listed corporation must include disclosures on the following:

(a) the governance structure in place to manage the economic, environmental and social risks and opportunities ("sustainability matters");

REGULATORY ASPECT OF ESG

Principles on Good Governance for GLICs to focus on ESG

- The Government via the Ministry of Finance launched the **Principles on Good Governance for GLICs (PGG)** on April, 2022 to ensure GLICs are ready to brace the market's demand on ESG.

- PGG suggests the formulation of a good governance structure to monitor ESG elements in their investment strategies.

- **The Ministry of Finance (MoF) said that the newly-launched PGG will be the primary reference for the baseline corporate governance standards and sustainability practices of all GLICs.**

- Malaysia's GLICs consist of six organisations, namely the **Employees Provident Fund (EPF), Permodalan Nasional Bhd (PNB), Retirement Fund(Incorporated) (KWAP), Khazanah Nasional Bhd, Lembaga Tabung Haji dan Lembaga Tabung Angkatan Tentera (LTAT).** These six GLICs have a total asset under management of RM1.7 trillion, making the GLICs one of the main pillars of Malaysia's socio-economic development.

The Ministry of Finance said that the PGG was prepared after taking into consideration standards, practices and discussions relating to public and corporate governance locally and abroad, including the **Malaysian Code on Corporate Governance** which was updated by the Securities Commission Malaysia in 2021.

The PGG is part of the GLIC/GLC Transformation(GLCT) Programme launched earlier.

REGULATORY ASPECT OF ESG

REGULATORY ASPECT OF ESG

Successful integration and effective management of sustainability at a company requires having **committed leadership, clear direction, and strategic influence**—and none of this will happen without a robust governance structure.

Sustainability governance helps a company implement sustainability strategy across the business, manage goal-setting and reporting processes, strengthen relations with external stakeholders, and ensure overall accountability.

Make sure there's a 'home' for ESG oversight, whether it's the governance committee, ESG committee or somewhere else in the board structure.

Effective oversight hinges on having the right people in the boardroom, supported with quality information to enable appropriate oversight.

REGULATORY ASPECT OF ESG

The Role of the Board in ESG

Board responsibilities:

- **Oversight the risks**, including workforce dynamics, innovating and incorporating new technologies, and supply chain disruptions due to natural disasters.
- **Disclose materiality, accuracy and reliability of data**. This starts with assessing the policies and procedures that are in place. The board will need to understand the internal controls over ESG disclosures.
- **Question if ESG-related risks or opportunities are significant** to the current business, and which may directly impact the balance sheet.
- **Constantly review their effectiveness in addressing ESG risk,** and should work with management to identify which ESG issues will impact the business most significantly. Risks and opportunities in these areas should be integrated into the formulation of strategies and operations.
- **Have regular briefings on the progress of ESG for strategic planning**. Have to identify emerging ESG risks that could negatively impact the firm's value in the long term and discuss how to mitigate them.

REGULATORY ASPECT OF ESG

The Role of the Board in ESG

Board responsibilities: Asking management the following questions:

- How has management **determined those ESG risks and opportunities** that could have a material impact on strategy, operations, or financial performance?

- How has management **assessed what ESG-related information is relevant** for each of its stakeholder groups? (*For employees: the decision to join or stay at the company. For communities: whether to support or oppose a facility in their town. For investors: to buy, sell, or hold the shares, to cast a vote for or against a particular director.)*

- Beyond investors, which **groups of stakeholders is the company accountable to**? Is the company considering the interests of employees, customers, suppliers, and communities? Has there been an assessment of how the broader group of stakeholders could impact long-term value?

REGULATORY ASPECT OF ESG

The Role of the Board in ESG

- **Boards must urgently incorporate sustainability practices and climate risks adaptation measures into their companies' strategies and operations** with the rising physical, economic and financial risks posed by climate change.
- **Boards must provide the stewardship necessary by integrating sustainability practices** and seizing the opportunities and incentives that come with this shift.
- **Boards must be vigilant against the potential for climate-related stranded assets**.
- **Boards need to ensure that the strategy and plans they put in place and decisions made are consistent with the changes** that can be expected from the institutional, regulatory and legal frameworks derived from these commitments and policies.

*Companies with a clear plan on sustainability, including supporting the global transition to a net-zero economy will **distinguish themselves by building the confidence of their stakeholders**, whilst unprepared boards and companies may see their businesses suffer, as these same stakeholders lose confidence in the ability of the company to adapt to shifts and changes in the global landscape.*

REGULATORY ASPECT OF ESG

Integrating ESG risk into board oversight responsibilities

To help boards prepare to address what is on the horizon for ESG and stay ahead of the rapidly changing environment:

1. **Define the board's governance infrastructure:** To set a proper governance structure, board members should understand how sustainability is linked to strategy, opportunities, and risks.

2. **Understanding the ESG management structure:** To exert sufficient influence, drive accountability, and ensure alignment with the business strategy. The CEO also plays a critical role in setting the tone at the top and underscoring the importance of the ESG program.

3. **ESG integrated into the company's strategic fabric:** ESG success depends on a well-defined strategy that aligns with the company's purpose and strategic direction.

REGULATORY ASPECT OF ESG

Integrating ESG risk into board oversight responsibilities

To help boards prepare to address what is on the horizon for ESG and stay ahead of the rapidly changing environment:

4. **Align risk and ESG oversight:** For many boards, the audit committee is the primary owner of risk oversight. In addition, committees should understand which ESG risks are deemed material and should be captured in sustainability disclosures.

5. **Understand the company's ESG maturity:** It is important for boards to understand where the company is on its ESG journey. This assessment can begin with specific questions related to ESG:

- ✓ Are the company's sustainability efforts **embedded in strategic decision making**?
- ✓ H as the company **defined the key elements** of its program and performed an ESG materiality assessment?
- ✓ Is the program **aligned to recognized standards** or frameworks?
- ✓ What **disclosures** are currently being made, and through what avenues?

REGULATORY ASPECT OF ESG

Integrating ESG risk into board oversight responsibilities

To help boards prepare to address what is on the horizon for ESG and stay ahead of the rapidly changing environment:

6. **Overseeing the adoption of an ESG framework:** The board should be engaged in any standards selection process and should be mindful of alignment that may be necessary based on the selection. Currently, the leading global ESG standard frameworks include these:

   - ✓ Sustainability Accounting Standards Board (SASB)
   - ✓ Climate Disclosure Standards Board (CDSB)
   - ✓ Task Force on Climate-related Financial Disclosures (TCFD)
   - ✓ Greenhouse Gas (GHG) Protocol
   - ✓ Global Reporting Initiative (GRI)

7. **Assure, disclose, and communicate:** Investors generally maintain that ESG disclosure is not nearly as robust or accessible as they would like. Even for companies with more extensive disclosures, questions arise about the quality, credibility, and reliability of the information. Board needs to ensure that management understands investor expectations.

REGULATORY ASPECT OF ESG

Integrating ESG risk into board oversight responsibilities

Full board oversee:

Strategy: Are ESG risks and opportunities integrated into the company's long-term strategy? How is the company measuring and monitoring its progress against milestones and goals set as part of the strategy?

Narrative/Messaging: Do ESG messaging and activities align with the company's purpose and stakeholder interests?

Risk assessment: Have material ESG risks been identified and incorporated into the ERM? Has the board allocated the oversight of these risks to the full board or specific board committees?

Reporting: What is the best communication platform to use for the company's ESG disclosures?

Directors have a big role to play in guiding management to allocate appropriate resources and attention in ESG risk management.

Forward-looking companies value being a frontrunner on ESG issues because they see the connection to the company's long-term success.

The reconfiguring of the traditional shareholder capitalism/shareholder primacy model into a broader stakeholder-centric ethic, closely aligned to ESG issues, requires risk managers to better understand the perceptions of all stakeholder groups. To do this, they need up-to-date intelligence on their own ESG liabilities, real time tracking of stakeholder sentiment and consistent benchmarking on ESG topics.

REGULATORY ASPECT OF ESG

BNM's Climate Change and Principle-based Taxonomy (CCPT)

On April 30, 2021, Bank Negara Malaysia (BNM) published Malaysia's national climate-focused sustainability taxonomy for the financial sector, the Climate Change and Principle-based Taxonomy (CCPT). The CCPT:

- sets out 5 Guiding Principles (GPs) intended to help financial institutions (FIs) **assess and categorise economic activities according to the extent to which they meet climate objectives and promote the transition to a low-carbon economy.**
- is aimed at encouraging the **adoption of ESG** principles by FIs.
- provides a **common framework for the classification of climate risk-related exposures** of financial institutions to support risk assessments and encourage financial flows towards greening the economy.

REGULATORY ASPECT OF ESG

BNM's Climate Change and Principle-based Taxonomy (CCPT)

The 5 Guiding Principles (GPs)

GP1: Climate Change Mitigation

An economic activity supports climate change mitigation if it makes a substantial contribution to the following objectives:

- ✓ **Avoiding** greenhouse gas emissions;
- ✓ **Reducing** greenhouse gas emissions; or
- ✓ **Enabling others** to avoid or reduce greenhouse gas emissions.

Economic activities that generally meet GP1 include the production and operation of **renewable power generation facilities, operation of electric vehicles and reforestation**.

GP2: Climate Change Adaptation

An economic activity supports climate change adaptation if it:

- ✓ Implements measures to **increase resilience to climate change** (e.g., resilience against the increased risk of extreme weather events); or
- ✓ Enables others to increase their resilience to climate change.

Economic activities that generally meet GP2 include **water conservation and rainwater harvesting, refitting buildings to cope with future climate conditions and building sea walls** in coastal areas.

GP3: No Significant Harm to the Environment

In addition to climate impacts, FIs should take into account the impact of economic activity on the broader environment.

An economy activity does **no significant harm to the environment** if it meets the following environmental objectives:

- ✓ **Preventing, reducing and controlling pollution**;
- ✓ Protecting **healthy ecosystems** and biodiversity; and
- ✓ Using energy, water and other natural resources in a **sustainable and efficient** manner.

BNM's Climate Change and Principle-based Taxonomy (CCPT)

The 5 Guiding Principles (GPs)

GP4: Remedial Measures to Transition

Importantly, the CCPT "considers the state of economic development of Malaysia and the nascent stage of climate risk management at which businesses and other economic agents are currently in."

CCPT seeks to **avoid the outright exclusion of economic activities that currently do not contribute to climate change objectives**.

This approach is intended to "avoid disruptive exclusions and dislocations" and **ensure an "orderly transition of the economy**."

GP5: Prohibited Activities

At a minimum, FIs should verify and ensure that economic activities are not illegal and do not contravene Malaysian environmental law. Prohibited activities include:

- ✓ Illegal deforestation;
- ✓ Illegal waste management; and
- ✓ Operations using fire for land clearance.

In addition to this minimum environmental safeguard, FIs are encouraged to assess whether **economic activities comply with Malaysian human rights and labour laws**, as well as the OECD Guidelines for Multinational Enterprise and UN Guiding Principles on Business and Human Rights.

REGULATORY ASPECT OF ESG

BNM's Climate Change and Principle-based Taxonomy (CCPT)

Scope and Applicability of the CCPT

The CCPT is intended to serve as a guide for BNM-supervised FIs including licensed banks, investment banks, Islamic banks, insurers and reinsurers, takaful and re-takaful operators and prescribed development financial institutions. Other financial sector stakeholders, including intermediaries, can refer to the CCPT to guide their investment and asset selection decisions.

- The CCPT is also intended to **facilitate standardized reporting of climate-related exposures**, encourage financial flows toward supporting climate objectives, assist in ratings decisions and support the design and structuring of green finance solutions and services.

- The CCPT complements the **Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) Guidance Document**. The VBIAF sets out ESG considerations in the governance, business strategy and operations, reporting and risk management systems.

BNM's Climate Change and Principle-based Taxonomy (CCPT)

Scope and Applicability of the CCPT

FIs are primarily encouraged to apply the GPs in **transaction due diligence processes** to assess whether an economic activity falls into one of **3 sustainability categories**:

- ✓ **Climate Supporting**: Activities with a positive impact on climate change mitigation (GP1) and/or adaptation (GP2), and no significant harm to the environment (GP3);
- ✓ **Transitioning:** Activities with a potential harm to the environment but remedial measures taken to reduce harmful practices (GP4); or
- ✓ **Watchlist:** Activities with a potential harm to the environment and no remedial measures taken to reduce harmful practices.

REGULATORY ASPECT OF ESG

Task Force on Climate-related Financial Disclosures (TCFD)

BNM & JC3 also issued the **Task Force on Climate-related Financial Disclosures (TCFD) Application Guide for Malaysian Financial Institutions** in March 2022 for public consultation.

- TCFD, which was established by the Financial Stability Board (FSB) in response to the Paris Agreement, **encourages consistent, reliable and clear measurement and reporting of climate-related financial risks.**
- Its recommendations provide an important **framework for understanding and analysing** how climate change impacts the customers, operations and strategy of the FIs
- The Task Force developed four widely adoptable recommendations on climate-related financial disclosures, published in June 2017, applicable to organisations across sectors and jurisdictions.
- The recommendations are structured around four thematic areas that represent core elements of how organisations operate – **Governance, Strategy, Risk Management, and Metrics and Targets.**

REGULATORY ASPECT OF ESG

Task Force on Climate-related Financial Disclosures (TCFD) – Governance & Strategy

The recommendations are structured around four thematic areas that represent core elements of how organisations operate – Governance, Strategy, Risk Management, and Metrics and Targets.

Governance:

- Disclose the organisation's governance around climate-related risks and opportunities.
- **Governance is a key component of an organisation's climate risk framework.**
- It defines, in the form of a board-approved **charter and governing policies, the roles, responsibilities and decision making mechanisms by which the organisation defines and delivers on its climate-related commitments** to key stakeholders such as customers, investors and the communities in which the organisation operates.

Strategy:

- Disclose the **actual and potential impacts of climate related risks and opportunities on the organisation's business, strategy, and financial planning** where such information is material.
- The Strategy pillar is intended to **provide important insights into climate-related exposures** faced by the business.
- It also addresses how responses to climate risks and opportunities are **integrated within the strategy** of the organisation, as well as how they are incorporated as part of financial planning and analysis.

REGULATORY ASPECT OF ESG

Task Force on Climate-related Financial Disclosures (TCFD) – Risk Management & Metrics and Targets

The recommendations are structured around four thematic areas that represent core elements of how organisations operate – Governance, Strategy, Risk Management, and Metrics and Targets.

Risk Management:

- Disclose how the organisation identifies, assesses, and manages climate-related risks.
- The risk management disclosures **address how the organisation identifies, measures, monitors, manages and reports climate-related risks**.
- They provide important insights into **how climate related risks are integrated within the firm-wide risk management framework.**

Metrics and Targets:

- Disclose the metrics and targets **used to assess and manage relevant climate-related risks and opportunities** where such information is material.
- Financial services firms' metrics and targets provide stakeholders with **important insights on how the capital allocation to carbon-intensive sectors is changing**.
- Metrics and targets are the mechanism for measuring and disclosing progress versus the commitments made to stakeholders with respect to managing and mitigating the impact of climate change.

REGULATORY ASPECT OF ESG

Task Force on Climate-related Financial Disclosures (TCFD)

Why should companies follow the TCFD?

- Conducting climate-related reporting through TCFD standards could help Malaysian companies have a framework or guideline to assess their climate-related risks and opportunities. This is critical, given that all businesses will be affected by climate-related risks eventually.
- **"It is critical for Malaysian companies to understand the climate-related risks and opportunities to their businesses,** so a proper strategy and action plan can be developed and implemented to address the risks and create new opportunities. It's all about improving business resilience,"
- Providers of capital, both debt and equity, are increasingly demanding for climate-related financial disclosures from companies.
- In Malaysia, several companies have already begun to report according to the recommendations by the Task Force on Climate-related Financial Disclosures (TCFD). Among these include Sunway Group Bhd, which is among the first few Malaysian companies to support the TCFD, CIMB Bank Bhd and Sarawak Energy Bhd.

TCFD: It gets companies to think about risk management and governance, setting metrics and targets and establishing a strategy to deal with existential threats — and that's new.

REGULATORY ASPECT OF ESG

Initiatives from the Government: Advancing Sustainability

The Malaysian government has initiated many initiatives to mitigate climate change and elevate sustainability towards achieving a low carbon economy. The Twelfth Malaysia Plan (RMK-12) sets out Malaysia's medium-term socioeconomic development plan for a period of five years, with 'Advancing sustainability' as one of the themes.

Climate Change Initiatives:

- The Malaysian government has made strides to mitigate climate change and elevate ESG issues in the country's journey towards becoming a low carbon economy.
- The **Twelfth Malaysia Plan (RMK-12)** sets out Malaysia's medium-term socioeconomic development plan for a period of five years, with 'Advancing sustainability' as one of the themes.
- In line with the RMK-12 objective of a 'Prosperous, Inclusive, Sustainable Malaysia', the country is committed to its target of becoming a carbon neutral nation by 2050 at the earliest.

Budget 2022's Initiatives on Climate Change:

- **Malaysia's Voluntary Carbon Market.** Voluntary Carbon Market initiative for carbon credit trading between green asset owners and other entities transitioning towards low-carbon practices. It will serve as a transparent and credible platform for the trading of carbon credits and carbon offsets by Malaysian companies, before transitioning to the domestic emissions trading scheme (DETS).
- **RM1 billion Low Carbon Transition Facility** by Bank Negara Malaysia (BNM) to help SMEs adopt sustainable and low carbon practices.
- **SME Bank's RM3 billion sustainability sukuk (bond) programme** - proceeds of which will be channelled to finance SME projects that directly support 11 of the 17 United Nations Sustainable Development Goals (SDGs)

Carbon-related:

- **Committed to be a carbon neutral country by 2050 at the earliest.**
- Increase **conservation of natural areas** to maintain at least 50% forest cover over the total land area.
- Conduct feasibility study on carbon pricing, carbon tax and Emission Trading Scheme aimed at creating **carbon taxation system** to incentivise behavioural changes and platform for carbon trading
- Promote Renewable Energy Certificate to enable procurement and trading of RE

REGULATORY ASPECT OF ESG

Initiatives from the Government: Advancing Sustainability

12th RMK initiatives:

Energy related:

- Formulate National Energy Policy 2021-2040
- Increase RE installed capacity to 31% by 2025
- Adopt new technologies, e.g. better energy storage systems
- Encourage waste-to-energy generation
- Promote existing mechanisms e.g. Green Tariff Rider and Renewable Energy Certificate to spur investments
- Introduce the Energy Efficiency (EE) & Conservation Act to regulate use of energy
- Promote EE, Energy Audit Conditional Grants (EACG) for selected industrial & commercial sectors
- Compliance of the National Building Energy Intensity (BEI) labelling in selected private properties
- No longer build new coal-fired power plants

12th RMK initiatives:

Transport related:

- Promote usage of green vehicles
- Encourage uptake of recognised green labelling for next generation vehicles and technologies
- Expand B20 biodiesel programme (contains 20% palm methyl ester) and B30 programme
- Intensified triple-helix collaboration, including Green Technology Financing Scheme (GTFS), Green Investment Tax Allowance (GITA) and Green Income Tax Exemption (GITE)
- Low-carbon mobility blueprint
- Low-carbon public transport
- Micro-mobility services to increase access to public transport
- User-friendly active mobility, pedestrian and cycling infrastructure

REGULATORY ASPECT OF ESG

An SC affiliate, Capital Markets Malaysia (CMM),has established three Centres of Excellence (COEs) to facilitate the growth of a sustainable and responsible capital market ecosystem focusing on three designated stakeholder categories: public-listed companies, financial sector intermediaries and asset managers.

CENTRE FOR SUSTAINABLE CORPORATIONS

The purpose of this COE is to build up sustainable practices amongst private sector companies and to ensure the manner in which these companies raise financing is sustainable. The COE will provide a platform to build up expertise and positioning of Malaysian PLCs as sustainable companies for investment by sustainable investors looking at opportunities in emerging market.

MSFI Malaysian Sustainable Finance Initiative

The Malaysian Sustainable Finance Initiative (MSFI) is established to support the Malaysian financial sector in further embracing the tenets of sustainable financing. MSFI is led by a Steering Committee which includes members representing stakeholder groups within the financial sector involved with financing green or sustainable projects. The objective of this Initiative is to provide the necessary impetus for industry stakeholders to facilitate capacity building, upskilling, awareness and thought leadership on sustainable finance.

SUSTAINABLE INVESTMENT PLATFORM

The Sustainable Investment Platform (SIP) was jointly established by the Institutional Investors Council Malaysia (IIC) and Capital Markets Malaysia (CMM) in April 2021 . The SIP's objective is to support institutional investors and the fund management industry in building the depth of sustainable and responsible investment (SRI) strategies which align financial returns with broader environmental, social and governance (ESG) priorities.

STARTING THE ESG JOURNEY

STARTING THE ESG JOURNEY

ESG is a process, not an outcome

1 Mapping

- Considering what stakeholders have at stake
- Identifying superpowers and vulnerabilities
- Benchmarking regularly and judiciously

2 Defining

- Considering high jumps and long jumps
- Thinking systematically about ESG trade-offs
- Measuring and assessing

3 Embedding

- Syncing ESG with operations
- Following through on initiatives to ensure impact
- Discerning what the numbers do—and do not—say about ESG

4 Engaging

- Using ESG engagement to sharpen strategy
- Showing investors the business proposition
- Making cadence core to the dialogue

Source: How to make ESG real, McKinsey Quarterly, August 2022

STARTING THE ESG JOURNEY

The Three Levels of ESG Ambition

Examples and organizational mindsets are segmented across three levels of an environmental, social, and governance (ESG) practice

Minimum practice

Risk-mitigation and "do no harm" measures

- React to trends affecting industry and business
- Address external vulnerabilities
- Donate resources (financial, in-kind, volunteer)
- Meet and report baseline standards
- Pledge to minimal commitment levels

Common practice

Substantive efforts, mostly outside the core business

- Track major trends affecting the business with contingency plans in place
- Use strengths to deliver increased value across specific ESG goals and metrics
- Comply with voluntary industry standards and perform above industry average
- Create a comprehensive sustainability policy
- Implement inclusive HR practices
- Run strategic, high-impact philanthropic programs
- Engage with stakeholder groups to understand what matters

'Next level' practice

Full integration of ESG into strategy and operations

- Leverage "superpowers" to move sector standards
- Increase social impact via innovation, market, and customer choices
- View ESG as a differentiator and core to overall strategy
- Link clearly articulated leadership areas ("win the game") with purpose
- Embed ESG in capital and resource allocation
- Tie ESG to employee incentives and evaluations
- Improve sustainability outcomes internally and externally
- Ensure that ESG disclosures cover company's full operations

Risk management ←→ **Impact**

Source: How to make ESG real, McKinsey Quarterly, August 2022

ESG Themes That Are Growing in Importance

When considering ESG approaches, it's important to recognize which underlying themes are producing some of the key risk factors. The following list highlights the more material ESG issues:

- **Climate change:** Investors care about climate change and are looking for greater disclosure on how it will affect companies. They will be closely watching trends including renewable energy.
- **Social inequalities:** The COVID-19 pandemic has brought social factors further into the spotlight. The pandemic has intensified social and gender inequalities, and there will be added pressure on companies to take greater accountability of the welfare of their workforce, the community at large, and individuals in their complex supply chains.
- **Supply chain management:** The need for greater transparency in global supply chains has been exacerbated by the COVID-19 pandemic. Companies will need to provide greater visibility into their operations related to labour practices, health and safety, and human rights.
- **Standardization:** There are a range of different sustainability reporting frameworks and standards some of which have already been adopted by Malaysian regulators. Standard-setters, such as the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB), are driving better alignment of sustainability reporting frameworks.

The Right Sustainability Framework

How and where sustainability fits into the overall corporate structure can indicate a company's direction and priorities

There is **no cookie-cutter structure that can be applied -** every company must tailor its approach for what makes most sense given its business model, structure, resources, and level of sustainability integration into the business.

4 considerations to keep in mind when building effective governance structures:

1. **Commitment starts from the top**. Reporting to the CEO or other key C-suite leadership can help demonstrate that a company is serious about sustainability.
2. **Accountability must be established and communicated clearly**. Accountability helps ensure that sustainability is integrated with other business goals. Including sustainability performance into the company's annual goals and employee performance review and compensation processes may be helpful mechanisms.
3. **Alignment between the structure and the business is imperative**. Sustainability governance structures that align with and complement the existing business model and organizational structures can be more successful than creating redundant or competing structures.
4. **Flexibility to adapt and build up on the sustainability program across business units to advance the sustainability agenda**. Allowing for some adaptation can help ensure the sustainability program's relevance to a business unit's own strategies.

Developing sustainability governance structures **may take time**, but it can help ensure successful management of ESG issues.

KEY TAKEAWAYS

- ESG is about the **future viability** of your business - your organization must be sustainable to have a viable business model.
- Understanding your stakeholders is non-negotiable.
- Malaysia is still in the **early stages** of its ESG journey – companies, regulators, investors (and other stakeholders) have just started developing their ESG programs.
- ESG regulatory aspects are developing, standards are converging, more will emerge in line with ESG appreciation and growth.
- ESG factors have become a global imperative, placing companies under increasing scrutiny. This heightened stakeholder focus means boards are confronted with new expectations.

COMMENTS & QUESTIONS

THANK YOU

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