



## Sustainable finance: A study on Malaysia's regulatory frameworks on sustainable banking and their implementation by selected Islamic banks in Malaysia in support of sustainable development goals.

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**ABSTRACT** - In 2018, Bank Negara Malaysia (BNM), the central bank of Malaysia, issued a Strategy Paper on Value-based Intermediation (VBI). VBI aims to deliver the intended outcomes of Shariah through Islamic Financial Institutions (IFIs) practices, conduct, and offerings that generate positive and sustainable impacts on the economy, community, and environment. To assist IFIs in translating VBI into actual banking practices and offerings, BNM issued guidance documents, one of which is the Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF). BNM also issued the Climate Change and Principle-based Taxonomy (CCPT), specifically addressing climate change. This article examines the VBI, VBIAF, and CCPT and investigates their adoption by three Islamic banks (IBs) in Malaysia. It aims to provide insight into the regulatory frameworks and how their adoption has influenced the banks' offerings, practices, and operations toward the Triple Bottom Line (TBL) approach in support of Sustainable Development Goals (SDGs). The findings reveal that the IBs have started implementing an impact-based risk assessment and management consistent with the VBIAF and climate risk assessment based on the CCPT. However, these are still in the preliminary stages for the IBs. Nonetheless, what is encouraging is that all three IBs have implemented various VBI-related initiatives in line with the underpinning thrusts of VBI. This paper illustrates how these various VBI-related initiatives by the IBs have assisted the banks in supporting sustainable development.

### ARTICLE HISTORY

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### KEYWORDS

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### INTRODUCTION

In September 2015, 193 member States of the United Nations (UN) adopted Agenda 2030 for Sustainable Development (United Nation, 2015). Agenda 2030 has five overarching themes: people, planet, prosperity, peace, and partnership. These themes span across 17 Sustainable Development Goals (SDGs) with 169 targets, covering issues on the well-being of the people (SDGs 1–5, 8, 11, 16), sustainable economy (SDGs 8–10, 12), and environmental issues including climate change (SDGs 6, 7, 11, and 15). The 17 SDGs are focus areas necessary to achieve sustainable development. To achieve the 17 SDGs, the estimated annual investment required across all sectors is around US\$5-7 trillion annually between 2015 and 2030 (UNCTAD, 2014). It is recognised that Financial Institutions (FIs) can contribute to the SDGs (UNCTAD, 2014).

According to the UN Global Compact and Klynveld Peat Marwick Goerdeler (KPMG) International, the financial industry can contribute to the SDGs by including sustainability risk analyses in financial decision-making. This inclusion can mobilise funds for sustainable projects and influence corporate clients to address environmental and social issues in their businesses (United Nations Global Pact and KPMG International, 2015). Under the United Nations Environmental Programme (UNEP) Statement of Commitment by FIs on Sustainable Development, FIs understood sustainable development as propagated by the Brundtland Commission (United Nations, 1987). They recognise that economic development needs to be compatible with human welfare and a healthy environment (UNEP, 2011). Furthermore, FIs acknowledge that they can critically contribute to sustainable development by interacting with other economic sectors and consumers and financing and investment activities.

In Malaysia, Bank Negara Malaysia (BNM) acknowledges that finance plays a role in helping to achieve the 17 SDGs (Mohd Yunus, 2018). To steer the Islamic financial industry toward supporting sustainable development, BNM issued a Strategy Paper on Value-Based Intermediation (VBI) (Bank Negara Malaysia, 2018a). The VBI is for voluntary adoption by IFIs, with an immediate focus on the Islamic banking industry. It aims to re-orient Islamic finance business models towards realising the intended outcomes of Shariah through IFIs' practices, conduct, and offerings that generate positive and sustainable impacts on the economy, community, and environment, consistent with the shareholders' sustainable return and long-term interests (Bank Negara Malaysia, 2018a). BNM has also issued guidance documents for the VBI implementation. These are (i) the Implementation Guide for VBI, (ii) the VBI Scorecard, Consultative Document, and (iii) the VBI Financing and Investment Impact Assessment Framework (VBIAF) Guidance Document (Bank Negara Malaysia, 2019). Several VBIAF Sectoral Guides have also been issued to support the implementation of the VBIAF. In addition to this, BNM also issued the Climate Change Principle-based Taxonomy (CCPT), which came into effect on April 30, 2021, to address climate change (Bank Negara Malaysia, 2021). The CCPT is a guide for all FIs supervised by BNM to assess and classify the FI economic activities based on the extent to which the activities meet climate objectives and promote transition to a low-carbon economy.

In this study, the VBI, VBIAF, and CCPT are referred to collectively as the regulatory frameworks for sustainable banking in Malaysia. The study examines the main features and influences of the regulatory frameworks on IBs' operations, practices, and offerings to support sustainable development. For this purpose, the study focused on three Islamic banks (IBs), which are Bank Islam Malaysia Berhad (Bank Islam), HSBC Amanah Malaysia Berhad (HSBC Amanah), and Bank Muamalat Malaysia Berhad (Bank Muamalat). All three IBs are founding members of the VBI Community of Practitioners (COP).<sup>3</sup> In addition to their role as founding members of the VBI COP, Bank Islam is a member of the Joint Committee on Climate Change (JC3)<sup>4</sup>. Meanwhile, Bank Muamalat is the first IB in the world to become a member of the Global Alliance for Banking on Values (GABV).<sup>5</sup>

## LITERATURE REVIEW

The issuance of the Strategy Paper on VBI by BNM has generated many discussions among researchers, banking practitioners and academicians. Studies have been conducted relating to Shariah principles that have been embodied in the VBI (Hassan & Mohammad Nor, 2019), the practices of specific IBs pursuant to the adoption of VBI (Mahadi et al., 2019; Syed Alwi et al.,

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<sup>3</sup> The VBI COP is a collaborative platform for industry players to advance industry-wide implementation of the VBI agenda. It facilitates the adoption of VBI through promotion of industry-wide knowledge exchange, acts as a single reference point to discuss and resolve implementation issues and implement strategic industry-level projects that demonstrate principles of VBI.

<sup>4</sup> The JC3 is a platform established in September 2019 to pursue collaborative actions for building climate resilience within Malaysia's financial sector. The JC3 is co-chaired by the Deputy Governor Bank Negara Malaysia and Deputy Chief Executive, Securities Commission Malaysia with members comprising senior officials from Bursa Malaysia and 19 financial industry players as well as relevant experts.

<sup>5</sup> GABV is a network of independent banks using finance to deliver sustainable economic, social and environmental development.

2021(a); Syed Alwi et al., 2021(b), the performance of selected IBs before and after VBI adoption, including issues and challenges faced by the industry players in realising the VBI (Ismail et al., 2020). The Association of Islamic Banking and Financial Institutions Malaysia (AIBIM) has also reported on the VBI initiatives by IBs based on the four VBI underpinning thrust (Association of Islamic Banking and Finance (AIBIM), 2020; Association of Islamic Banking and Financial Institutions Malaysia (AIBIM), 2021)).

Several researches also discussed the correlation between VBI and the SDGs (Khan, 2021) (Mahadi et al., 2019). The role of the Board of Directors and Shariah Committee in VBI implementation is also a matter which has generated discussions among researches and banking practitioners (Mahyudin & Rosman, 2020). On the other hand there are limited literatures that discuss the VBIAF and CCPT. Available literatures on the CCPT generally explains the CCPT and its implication on financial institutions (Pfaff et al., 2021; Deloitte, 2021).

This paper takes a different approach by first, studying the regulatory framework of VBI holistically through the examination of not only the VBI as articulated under the Strategy Paper, but also the VBIAF. Second, this paper goes further to investigate the extend the regulatory frameworks of VBI and VBIAF have influenced or changed the operations, practices and offerings of three selected IBs in Malaysia. Third, this study will also examine the CCPT's general principles and classification system. It investigates the extend IBs in Malaysia consider climate change issues and have adopted the CCPT or similar taxonomy. A study on the regulatory frameworks of sustainable banking will not be complete without examining the regulatory framework that addresses climate change. This is especially so when one of the SDGs agreed to by Malaysia under Agenda 2030 is SDG 13 which is to “take urgent action to combat climate change and its impacts”. The financial industry has also acknowledged that the banking sector can be affected by climate change through physical risks and transition risks (Ozili, 2020). Thus, the justification to undertake a study on CCPT as mentioned above. Finally, the paper will explore how the changes in the operations, practices and offering of the three selected IBs through the adoption of the VBI, VBIAF and CCPT assisted the selected IBs to support sustainable development.

The aim of the above approach is to provide an understanding on the correlation between VBI as articulated in the Strategy Paper, the VBIAF and the CCPT and how the adoption of these frameworks can change the operations, practices and offerings of IBs towards adding value to the economy, environment and community supporting sustainable development.

## **METHODOLOGY**

This is a preliminary study as part of a thesis that examines the regulatory frameworks of sustainable banking in Malaysia and its adoption by IBs in Malaysia. To understand the key features of the VBI, VBIAF, and CCPT, the Strategy Paper on VBI, the VBIAF guidance document, as well as the CCPT were studied together with BNM's press releases and other works of literature available. This includes books, journals, and internet sources discussing these regulatory frameworks. For purposes of examining how these regulatory frameworks influenced the offerings, practices, and operations of the three IBs, the Annual Report 2016 (pre-adoption of the VBI) and Annual Report for years 2017 – 2022 (post-adoption of the VBI) of Bank Islam and Bank Muamalat were examined. Notably, HSBC Amanah issued a specific report on VBI disclosure in 2019. It also issued a summary of its Triple Bottom Line Framework (TBL) and its Task Force on Climate-Related Financial Disclosure (TCFD) for three consecutive years (i.e., 2020, 2021, and 2022). All these documents were studied for the purposes of this research. In addition to the annual reports and other reports on sustainability and climate change issued by the three IBs, information posted on the IBs' corporate websites, such as company policies, statements, and press releases, was also examined.

## RESULTS

### VBI under the Strategy Paper

The VBI is for the voluntary adoption of IFIs. The Strategy Paper specifies that the VBI “aims to deliver the intended outcomes of Shariah through practices, conduct, and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders’ sustainable returns and long-term interests.” (Bank Negara Malaysia, 2018a) The statement has three components. The first component is the end objective of the VBI, which is the intended outcomes of Shariah. The “intended outcomes of Shariah” as explained in the Strategy Paper focuses on enhancement of well-being of the people through preservation of wealth, faith, lives, posterity, and intellect. Primarily, its purpose is to achieve benefits for all human beings and to prevent harm. Therefore, the end objective of VBI, as articulated under the Strategy Paper, is to support sustainable development. Djafri and Soualhi (2021), who studied the relationship between the objectives of Shariah and the SDGs, concluded that there is a strong link between both as they are to achieve socio-economic justice and increase human well-being (Djafri & Soualhi, 2021). Nonetheless, it is interesting to note that the protection of religion is not a concern under the SDGs. On the other hand, Shariah emphasises both the material and spiritual aspects of life. In contrast to the conventional view on development, the basis of the Islamic view on development emphasises the need to form an ecosystem that allows humans to enjoy socio-economic, moral, and spiritual well-being in the world and hereafter (Zailani, Mohd Satar, & Zakaria, 2022).

The second component is the approach to achieve the end objective of delivering the “intended outcomes of Shariah.” The approach requires IBs to adopt practices and conduct and provide offerings to the public that generate positive and sustainable impacts on the economy, community, and environment. Meanwhile, the third component refers to the profit to shareholders and the long-term interests of the bank. This suggests that under VBI, what is equally important to the “intended outcome of Shariah,” the sustainability of the planet, and economic growth is the growth and sustainability of the IBs and, consequently, the Islamic finance industry.

Based on the three components, the aim of the VBI appears to reflect the TBL approach. The TBL approach lends a sustainable perspective when measuring business performance by adding both social and environmental dimensions to the traditional economic results of a business (Elkington, 1998). Under VBI, the IB’s contribution to social well-being, environmental health, the economy, and the profit to shareholders are measures of IB’s performance. Thus, IBs that adopt the VBI cannot merely focus on profit and compliance with Shariah. They also must ensure that their practices, operations, and offerings positively impact the environment, people, and economy and minimise and prevent any negative impact. Furthermore, this approach is consistent with the aspirations of Agenda 2030 on sustainable development, which are to promote and enhance the well-being of the people, protect and preserve the planet and its natural resources, and promote sustainable economic growth (United Nations, 1987).

The Strategy Paper also listed four underpinning thrusts on which IBs should premise intent, strategy, and business performance to create intermediation with value, as follows:

i. Entrepreneurial mindset

Under the thrust of the entrepreneurial mindset, IBs should have greater involvement in facilitating entrepreneurial activities. IBs will achieve this by providing a comprehensive product and service set supporting businesses and entrepreneurs. This effort includes financing and proactive support, such as advisory, market infrastructure, and business networks (Bank Negara Malaysia, 2018a).

ii. Community empowerment

Under the thrust of community empowerment, IBs should empower communities by providing financial solutions that create a positive socio-economic impact. This empowerment exists when an IB develops and provides a financial solution that addresses issues in the community or positively impacts the community (Bank Negara Malaysia, 2018a).

iii. Good self-governance

The thrust of good self-governance focuses on the IB’s governance (Bank Negara Malaysia, 2018a). Note that there are two components to this thrust. The first component is inclusive governance, requiring IBs to engage their stakeholders in key decision-making processes. The second component entails IBs inculcating a culture of self-discipline within their operations and practices (Bank Negara Malaysia, 2018a). This thrust is vital to ensure that an IB acknowledges the issues among its stakeholders and that its business direction, practices, and operations address those issues.

iv. Best conduct

This thrust refers to the IB’s treatment of its stakeholders (Bank Negara Malaysia, 2018a). This thrust requires IBs to adopt practices that improve the IBs’ offerings, processes, and treatments toward their stakeholders to enhance their satisfaction.

Besides the four underpinning thrusts, IBs that adopt the VBI must disclose their adoption intention, formulate implementation strategies, and develop Key Performance Indicators (KPI) (Bank Negara Malaysia, 2018b) (Bank Negara Malaysia, 2018a). The KPI will provide a quantifiable measurement of the IB’s performance in its VBI implementation strategies. Finally, the IB may report to their stakeholders on the progress of the implementation strategies. Thus, the VBI requires two forms of disclosure: the IB’s intention to adopt VBI and the progress on its VBI implementation strategies. The practice will promote the VBI transparency and accountability of the IB, providing the necessary information to stakeholders for effective activism in ensuring that the IB meets its VBI objectives aligned with the SDGs. The following section elaborates on how the IB disclosures and the underpinning thrusts of the VBI facilitate IB contributions to the SDGs.

### Implementation of VBI by Bank Islam, HSBC Amanah, and Bank Muamalat

#### *Bank Islam*

Bank Islam is the first IB established in Malaysia and Southeast Asia to offer its customers Shariah-compliant and personal and corporate banking services. Bank Islam adopted the VBI in 2017, transforming various aspects of its banking operations, practices, and offerings to reflect the VBI initiatives. Table 1 narrates some of the changes that were implemented by Bank Islam after the VBI adoption.

**Table 1:** Implementation of VBI by Bank Islam

Disclosure of intention to adopt VBI.	The bank’s business model focuses on how its banking business can support economic, social, and environmental development. This support is evident from Bank Islam’s vision, which is “The Bank that Advances Prosperity for All,” and its mission, which is “To Provide Solutions That Deliver Value” (Bank Islam Malaysia Berhad, 2018, p. 19). Based on this vision, prosperity is not confined only to profits to its shareholders; the bank seeks to facilitate the economic development of its other stakeholders, which is evident from the social finance initiatives the bank undertakes. This will be elaborated on in the following paragraphs. The notion of “Value” in its mission is expanded to encompass benefits delivered to society and the environment as well as the economy (Bank Islam Malaysia Berhad, 2018, p. 25).
Formulation of implementation strategies for VBI and setting of KPI.	Bank Islam developed a strategic plan for the period 2019-2021, CODE21, with a strategic focus on supporting the economy, community, and environment (Bank Islam Malaysia Berhad, 2019).  Under CODE21, the Centre of Social Finance was established. This is an operating unit in the bank that is tasked to specifically pioneer social finance

	<p>initiatives of the bank by connecting traditional banking instruments with Islamic social finance models (Bank Islam Malaysia Berhad, 2019, p. 7).</p> <p>Bank Islam also developed KPIs to drive behaviours and measure performance towards targets that support economic and social activities and environmental causes (Bank Islam Malaysia Berhad, 2017, pp. 51-64).</p> <p>For the year 2022 onwards, the bank embarked on a five-year strategy roadmap, LEAP25. This is where the bank aims to be a champion in offering Shariah-ESG total financial solutions by increasing its Environment, Social, and Governance (ESG)-related financing assets to RM4 billion by the financial year 2025 (Bank Islam Malaysia Berhad, 2022a, p. 111) and to establish its leadership in social finance (Bank Islam Malaysia Berhad, 2021b, p. 15). As part of the LEAP25 strategy, the bank incorporated five sustainability commitments aligned with the UN SDG 7,8,10,11, and 13 (Bank Islam Malaysia Berhad, 2022a, p. 112).</p>
<p>Underpinning thrust of entrepreneurial mindset.</p>	<p>Through its Centre of Social Finance, Bank Islam initiated the BangKIT microfinance facility, which aims to assist underbanked micro-entrepreneurs who intend to start a business or grow their existing business. Through BangKIT, these entrepreneurs are also exposed to practical business coaching and mentoring for business development and sustainability. The financing is provided with no profit rate imposed by the bank (Bank Islam Malaysia Berhad, 2021c, p. 31).</p> <p>Bank Islam also made allocations and disbursements towards Micro iTEKAD<sup>6</sup> to assist micro-entrepreneurs in growing their business.</p> <p>For the year 2022, RM9.9 million was distributed under iTEKAD and BangKIT to help micro-entrepreneurs, including training programmes for them, benefiting 566 micro-entrepreneurs (Bank Islam Malaysia Berhad, 2022a, pp. 35,139).</p>
<p>Underpinning thrust of community empowerment.</p>	<p>Driven by ESG and VBI aspirations, Bank Islam offers financial products and services to uplift and empower local communities through its corporate social responsibility arm, AMAL Bank Islam (AMAL) (Bank Islam Malaysia Berhad, 2016, p. 28). AMAL's focus is on four key priorities which are:</p> <ul style="list-style-type: none"> <li>• Housing Aid Project, which provides impoverished families with the basic need of a conducive home.</li> <li>• Community, which focused on fostering the spirit of solidarity and compassion among communities.</li> <li>• Education promotes innovation and creativity among youths while supporting underprivileged students in getting the education they deserve.</li> <li>• Environment, where the bank focuses on increasing environmental awareness while minimising the environmental impact for a cleaner and greener planet.</li> </ul> <p>For the year ending 2022, a total of RM918,350 was invested by the bank in AMAL activities (Bank Islam Malaysia Berhad, 2022a, p. 33).</p> <p>In addition to the above, the bank offers its Personal Financing-I (ASNAF), a house ownership financing scheme, to assist underprivileged individuals who</p>

<sup>6</sup> Malaysia's Prime Minister on 27 March 2020 announced (iTEKAD), as part of the Prihatin Rakyat Economic Stimulus Package (ESP) as an additional measure in assisting the underprivileged in generating sustainable income and achieving financial resilience.

	<p>are ineligible for personal or housing financing. Implemented through a joint venture with the State Zakat Management Agency, the scheme enables individuals with a fixed income of below RM1,500 per month to own a house (Bank Islam Malaysia Berhad, 2021a). As of September 2021, two pilot recipients received houses that were financed by the Personal Financing-I (ASNAF) and zakat that carries a monthly instalment of RM300 for ten years (Association of Islamic Banking and Financial Institutions Malaysia (AIBIM), 2021).</p> <p>The bank also established the Sadaqa House, a charity crowdfunding platform where the public can contribute to realising social finance projects for sectors. This includes healthcare, education, and other social ventures through Bank Islam’s collaboration with identified partners (Bank Islam Malaysia Berhad, 2018, p. 35). In 2022, the bank collected RM7.3 million for Sadaqa House, and RM5.1 million was distributed to benefit 10,545 individuals, institutions, and micro-entrepreneurs (Bank Islam Malaysia Berhad, 2022a, pp. 24,140).</p>
<p>Underpinning thrust of good self-governance.</p>	<p>The bank established a two-tier sustainability governance structure (Bank Islam Malaysia Berhad, 2022a, p. 114).</p> <p>First, the Board’s oversight of sustainability and climate-related matters:</p> <ul style="list-style-type: none"> <li>• The Board Strategic and Sustainability Committee (BSSC) oversees the bank’s sustainability strategy, including carbon footprint management, ESG projects and initiatives, and sustainability initiatives by segment.</li> <li>• The Board Risk Committee (BRC) oversees the bank’s risk tolerance for financial and non-financial risks, including ESG and climate risks.</li> </ul> <p>Second, sustainable governance at the management level:</p> <ul style="list-style-type: none"> <li>• The Group Chief Executive Officer (CEO) is responsible for the bank’s ESG targets and is supported by all the bank’s divisions.</li> <li>• The Planning and Sustainability Department is responsible for sustainable initiatives.</li> <li>• The Credit Management Division manages the ESG risk and transactional credit-related climate risk.</li> <li>• The Risk Management Division manages the climate-related portfolio credit, market, liquidity, and operational risks.</li> <li>• Management Sustainability Committee and Management Risk Control Committee provide oversight and report to BSSC and BRC, respectively.</li> </ul>
<p>Best conduct.</p>	<p>Bank Islam regularly engages with all its stakeholders, including customers, to identify the ESG issues as well as the bank’s ability to create values that address those issues. To nurture a culture of integrity and governance, the bank introduced Think customer, Act with integrity, Advance beyond, Take charge (TAAT) values as part of its value-based strategic objectives (Bank Islam Malaysia Berhad, 2019).</p> <p>In the year 2022, the bank launched its first environment-friendly branch in Temerloh, Pahang, and its first environment-friendly contact centre in Sg Petani, Kedah (Bank Islam Malaysia Berhad, 2022a, p. 110).</p>
<p>Reporting of VBI initiatives</p>	<p>Following the adoption of VBI, Bank Islam implemented an integrated reporting of its Annual Reports, which includes reporting on the non-financial performance of the bank, that is, its VBI and climate change initiatives. Its first Integrated Annual Report was published in 2019. The integrated reports are prepared in accordance with the International Integrated Reporting Framework, Malaysian Code on Corporate Governance 2021, Companies Act 2016, BNM Corporate Governance Policy, and Bursa Malaysia’s Sustainability Reporting Guide.</p>

### ***HSBC Amanah***

HSBC Amanah is a full-fledged IB owned by HSBC Bank Malaysia Berhad, an HSBC Group member headquartered in London, United Kingdom. Its business encompasses Wealth and Personal banking, Commercial banking, and Global Banking and Markets, comprising capital market and advisory services. HSBC Amanah adopted the VBI in 2017. Table 2 summarises some initiatives of HSBC Amanah after adopting the VBI.

**Table 2:** Implementation of VBI by HSBC Amanah

<p>Disclosure of intention to adopt VBI.</p>	<p>The bank's VBI Disclosure Report states that HSBC Amanah's approach to VBI is captured under the three pillars of people, planet (environment), and prosperity (HSBC Amanah Malaysia Berhad, 2019). Following this approach, the bank's business model began adopting best practices that resulted in a long-term impact on its stakeholders. This includes the offering of products and services which not only serve its customers but also the communities and which benefit the environment. Some examples are:</p> <ul style="list-style-type: none"><li>• The ESG credit card with linked charity features (HSBC Amanah Malaysia Berhad, 2021b, p. 35). The ESG credit card is made from 85% recycled plastic, and charitable donations made by cardholders are channelled to selected local charities/ non-profit organisations (HSBC, 2021a);</li><li>• the green trade financing facility for sustainable cocoa sourcing in Malaysia for a cocoa manufacturer (Shankar, 2021);</li><li>• HSBC Amanah Islamic Structured Product allows customers to invest in a product that matches their values regarding environmental and social causes. It is linked to the Hang Seng Corporate Sustainability Index, which tracks the performance of Hong Kong-listed companies that excel in corporate sustainability. Some common topics examined by the index include climate change impact, energy efficiency, health and safety, corporate governance, and business ethics (HSBC Amanah Malaysia Berhad, 2019) (HSBC, 2021a).</li></ul>
<p>Formulation of implementation strategies for VBI and KPIs.</p>	<p>HSBC Amanah launched Project Cocoon to embed sustainability into the HSBC Amanah through the lens of TBL. Under Project Cocoon, the following three initiatives were undertaken:</p> <ul style="list-style-type: none"><li>• The bank developed a classification tool to meet a set of defined quantitative and qualitative goals of being a sustainable bank. One of the goals is to ensure that 51% of HSBC Amanah's financing can be classified as TBL Assets.</li><li>• The bank offers more customised financing solutions to customers according to their personal sustainable needs.</li><li>• The bank worked to create a shift in mindset towards sustainable living and banking practices through various training and events related to sustainability (HSBC Amanah Malaysia Bhd, 2020a).</li></ul> <p>To enable HSBC Amanah to achieve its goal of having 51% of its assets be TBL Assets, the bank launched its TBL Framework (HSBC Amanah Malaysia Bhd, 2022b). The TBL Framework applies to all financing assets originated by or managed by HSBC Amanah. Screening is performed at both customer and transaction levels. The screening is undertaken at the customer and transaction levels per Table 3.</p>



	<p><b>Table 3:</b> HSBC Amanah screening under the TBL Framework (HSBC Amanah Malaysia Bhd, 2022b, p. 7)</p> <table border="1" data-bbox="539 264 1302 902"> <tr> <td colspan="2" data-bbox="539 264 1302 300">TBL Wealth and personal banking classification</td> </tr> <tr> <td data-bbox="539 300 783 398">Customer level screening</td> <td data-bbox="783 300 1302 398">Customers are identified based on pre-defined income segments with a view to maximise positive impact.</td> </tr> <tr> <td data-bbox="539 398 783 566">Transaction level screening</td> <td data-bbox="783 398 1302 566">Whether the financing positively impacts one or more of the UN SDGs in terms of basic needs, health, first home ownership, education, medical, debt consolidation, and payment relief.</td> </tr> <tr> <td colspan="2" data-bbox="539 566 1302 602">TBL Wholesale banking classification</td> </tr> <tr> <td data-bbox="539 602 783 770">Customer level screening</td> <td data-bbox="783 602 1302 770">Customers are identified based on the Wholesale TBL Framework aligned to green, social, and sustainable standards or other standards that consider environmental and social impacts.</td> </tr> <tr> <td data-bbox="539 770 783 902">Transaction level screening</td> <td data-bbox="783 770 1302 902">Whether the proceeds are used in line with green, social, sustainable standards or other standards that consider impacts on the environment and society.</td> </tr> </table> <p>Based on the screening above, assets that meet the parameters of the TBL Framework are classified as TBL Assets. As of the end of 31 December 2022, HSBC Amanah’s target of TBL Assets reached 49% (HSBC Amanah Malaysia Berhad, 2022b, p. 26)</p>	TBL Wealth and personal banking classification		Customer level screening	Customers are identified based on pre-defined income segments with a view to maximise positive impact.	Transaction level screening	Whether the financing positively impacts one or more of the UN SDGs in terms of basic needs, health, first home ownership, education, medical, debt consolidation, and payment relief.	TBL Wholesale banking classification		Customer level screening	Customers are identified based on the Wholesale TBL Framework aligned to green, social, and sustainable standards or other standards that consider environmental and social impacts.	Transaction level screening	Whether the proceeds are used in line with green, social, sustainable standards or other standards that consider impacts on the environment and society.
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Underpinning thrust of entrepreneurial mindset.	<p>HSBC Amanah participated in the following:</p> <ul style="list-style-type: none"> <li>• Schemes such as SME Financing Scheme, Working Capital Guarantee Scheme, PENJANA, and Special Relief Facility assist Small and Medium-sized Enterprises (SMEs) in either sustaining or expanding their businesses. As of September 2021, RM43 million worth of financing was approved by HSBC Amanah to assist SMEs (Association of Islamic Banking and Financial Institutions Malaysia (AIBIM), 2021).</li> <li>• The BNM financial relief initiative is known as Targeted Relief Assistance (TRA) and is used to ease the repayment difficulties of SME businesses due to the Movement Control Order (MCO). A total of 222 SMEs’ repayments have been structured under the TRA programme (Association of Islamic Banking and Financial Institutions Malaysia (AIBIM), 2021).</li> </ul>												
Underpinning thrust of community empowerment.	<p>In 2017, HSBC Amanah introduced the industry’s first VBI-related product, Takaful Future Secure, which is specially designed to ensure that wealth accumulated by customers is protected and can be transferred to their loved ones for them to secure a brighter future (HSBC Amanah Malaysia Berhad, 2019, p. 13). HSBC Amanah’s commitment to empowering the community can also be observed through the support of the corporate sustainability initiatives performed by its parent bank, HSBC Bank Malaysia, which focuses on employability and financial capability.<sup>7</sup></p> <p>In 2018, HSBC Amanah issued the first UN SDG Sukuk, which supports financing for businesses that fall within the selected seven UN SDG bond framework, which includes SDG 3 (healthy lives and well-being for all) and SDG 4 (education) (HSBC Amanah Malaysia Berhad, 2019).</p>												
Underpinning thrust of good governance.	<p><u>Board Governance</u></p> <p>The Board is entrusted with steering the bank toward a sustainable future through appropriate ESG considerations in the bank’s business strategies.</p>												

<sup>7</sup> Examples of such initiatives are available at <https://www.about.hsbc.com.my/hsbc-in-malaysia/community>

	<p>Through the BRC, the Board provides primary oversight of its strategic approach to climate change, executed by the Executive Committee and the Risk Management Meeting.</p> <p><u>Management Governance</u></p> <p>The Executive Committee, comprising key senior management and chaired by the CEO of the bank, has responsibility for the identification and implementation of business and risk strategies, opportunities, and policies in accordance with the direction given by the Board after considering various aspects of enterprise-wide risk including climate risk (HSBC Amanah Malaysia Berhad, 2022b).</p> <p>The Climate Risk Oversight Forum was established to manage all risks relating to HSBC Amanah’s approach to climate risk management (HSBC Amanah Malaysia Berhad, 2022b).</p> <p>The Cocoon Project Management Office (PMO) was established to –</p> <ul style="list-style-type: none"> <li>• Plan and oversee the progress and milestones of all initiatives under the Cocoon Project.</li> <li>• Create frameworks and guidelines in strategic alignment with HSBC Group’s ambition, BNM, VBI, and JC3.</li> <li>• Act as the centralised information centre for management reporting (HSBC Amanah Malaysia Berhad, 2019, p. 16).</li> </ul> <p>It reports directly to HSBC Amanah’s CEO.</p>
Underpinning thrust of best conduct.	HSBC Amanah actively engages with its stakeholders and gathers customer feedback through interactions, surveys, social media, and compliant channels to understand what is essential to its customers and how its performance can be improved (HSBC Amanah Malaysia Berhad, 2019).
Reporting of VBI initiatives	HSBC Amanah published its first VBI disclosure in 2019, articulating its VBI approach and how it implements the VBI underpinning thrusts (HSBC Amanah Malaysia Berhad, 2019).

### ***Bank Muamalat***

Bank Muamalat, established in 1999, is the merger of Bank Bumiputera Malaysia, Bank of Commerce (Malaysia) and BBMB Kewangan. Its business consists of business and retail banking, which offers consumer banking, wealth management, deposit services, and investment banking. Bank Muamalat adopted the VBI in 2017. Table 4 narrates some of Bank Muamalat’s initiatives after the VBI adoption.

**Table 4:** Implementation of VBI by Bank Muamalat

Disclosure of intention to adopt VBI.	<p>Following the adoption of VBI, the bank describes itself as “a value-driven IB and aims to contribute to a sustainable financial ecosystem.” In line with this, it declares that it adopts strategies to balance its objectives with economic, environmental, and social considerations as it strives to become the preferred Islamic financial service provider (Bank Muamalat Malaysia Berhad, 2018, p. 4). The bank’s mission statement also changed from “To Deliver Best Value to the Stakeholders” to “To ethically Deliver Best Value to the Stakeholders, Society and Environment.” (Bank Muamalat Malaysia Berhad, 2018, p. 19). This change in the mission statement reflects the integration of sustainability in the bank. It has five core values, one of which is CARE, where the bank “cares about the growing needs of our society and environment by providing effective service and product solutions” (Bank Muamalat Malaysia Berhad, 2018, p. 4). To reflect its commitment to sustainable development, following its adoption of VBI, the bank also became the first IB to be a member of GABV.</p>
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	<p>In line with VBI, the bank employs Maqasid Shariah principles as the underlying principles that guide its operations and decision-making on material sustainability matters. It adopts five out of the 17 SDGs as its target. The five SDGs are SDG 4 on quality education, SDG 8 on decent work and economic growth, SDG 10 on reducing inequalities, SDG 12 on responsible consumption and production, SDG 16 on peace, justice, and strong institutions (Bank Muamalat, 2022, p. 78).</p>
Formulate implementation strategies for VBI and KPIs.	<p>Bank Muamalat embarked on a five-year strategic business plan, RISE24, for the years 2020 to 2024. It is driven by seven strategic focus areas (7 SFAs) guided by the overarching principles of VBI (Bank Muamalat, 2019, pp. 16,40). Each of the SFAs is designated with specific KPIs. Phase 1 of RISE24 for the period 2020 – 2021 focused on building sustainable growth, which includes the continuous adoption of industry best practices in VBI by the bank.</p> <p>Following RISE24, a new strategic plan, RISE26+, is being developed for the years 2022-2026. RISE 26+ outlines five aspirations, including promoting VBI and sustainability, and eight strategic thrusts, including driving sustainability (Bank Muamalat, 2021, p. 54).</p>
Underpinning thrust of entrepreneurial mindset.	<p>To encourage and facilitate entrepreneurial activities, Bank Muamalat undertook the following initiatives:</p> <ul style="list-style-type: none"> <li>• The bank launched iTEKAD Mawaddah, an equity-based investment where the bank will source funds from investors to invest in businesses owned by B40 (bottom 40% of the Malaysian household income category) individuals and micro-entrepreneurs (Bank Muamalat, 2021, p. 84).</li> <li>• The bank participated in the Targeted Relief and Recovery Financing programme to assist SMEs in sustaining and revitalising their business. As of December 2021, RM158 million had been approved by Bank Muamalat under the programme, and RM136 million was disbursed directly to SMEs. Meanwhile, 546 SME companies benefitted from the allocation and disbursement (Bank Muamalat, 2021, p. 84).</li> <li>• The bank collaborated with various strategic partners on various financial assistance programmes with the objective of assisting SMEs and mid-sized companies in restoring their business. As of December 2021, RM76.2 million was approved under these financial assistance programmes (Bank Muamalat, 2021, p. 84).</li> <li>• The bank offered payment assistance packages to SMEs who could not afford to pay for their existing facilities due to business disruptions due to MCO restrictions. A total of RM71 million of these payment assistance packages was approved, which helped 190 SMEs to restore their business (Bank Muamalat, 2021, p. 84).</li> <li>• The bank launched the SIRIM-Fraunhofer programme to enhance the productivity and competitiveness of SMEs, especially in the manufacturing sector (Bank Muamalat, 2020, p. 25).</li> <li>• FY2022, the bank launched the iTEKAD Qard with the Pahang state government and disbursed RM6.3million through the Skim Pembiayaan Mikro Negeri Pahang (i-PUSH) scheme, which extended financing to 751 Asnaf and B40 entrepreneurs (Bank Muamalat, 2022, p. 46).</li> </ul>
Underpinning thrust of community empowerment.	<p>The bank seeks to empower communities through its social finance initiatives such as Wakaf Muamalat, Tabung Mawaddah, and the Jariah Fund (Bank Muamalat, 2020, p. 103) (Bank Muamalat, 2021, p. 99).</p> <p>Through Wakaf Muamalat, the bank collaborates with State Religious Councils to manage cash wakaf funds. Since its inception in 2012, Wakaf Muamalat has</p>

	<p>approved 128 projects in education and health (Bank Muamalat, 2021, p. 99). The total wakaf fund collection for FY2022 was RM33,778,184.3, out of which RM25,732,687.4 has been approved for 132 projects in education, health, and investment (Bank Muamalat, 2022, p. 99).</p> <p>Tabung Mawaddah is an internal charitable fund of the bank dedicated to implementing charitable activities for Asnaf recipients. In FY2022, Bank Muamalat disbursed a total of RM949,560.4 of the Tabung Mawaddah fund to aid selected Asnaf and non-Asnaf recipients on social, education, and health-related matters (Bank Muamalat, 2022, p. 99).</p> <p>The Jariah Fund, established in September 2020, is a social welfare crowdfunding platform for charitable projects that aim to generate a sustainable impact on the economic growth of the people under the pillars of education, health, and economic empowerment. For FY2022, Jariah Fund has collected RM86,809 (Bank Muamalat, 2022, p. 99).</p> <p>Bank Muamalat also collaborated with Syarikat Jaminan Kredit Perumahan (SJKP) and Skim Rumah Pertamaku (SRP) to provide home financing to low-income earners, self-employed individuals, and operators of small business entities. Through SKJP, RM125.1 million was disbursed, whereas, under SRP, RM190.2 million was disbursed (Bank Muamalat, 2021, p. 21). It also launched the Smart Mortgage Solution programme to serve the underserved by providing financing for affordable homes to lower-to-middle income earners, self-employed individuals, and operators of small business entities. FYE 2020, RM257 million was disbursed (Bank Muamalat, 2020, p. 18).</p>
Underpinning thrust of good self-governance.	<p>Bank Muamalat Board oversees the overall sustainability strategies and advises on sustainability matters. Its Management Committee deliberates, oversees, and acts as custodian to all sustainability and value-based initiatives executed by the respective Heads of Departments (Bank Muamalat, 2022, p. 79).</p> <p>Bank Muamalat also has a Social Finance Department that strategises and materialises the value of the Tabung Mawaddah and Wakaf Fund to ensure the diversified usage of the funds (Bank Muamalat, 2020, p. 82).</p>
Underpinning thrust of best conduct.	<p>Bank Muamalat is a member of GABV. It is the first IB in the world to join GABV. The bank is the project manager for the VBIAF Sectoral Guide on Energy Efficiency and a member of the VBIAF Sectoral Guides on Construction (Bank Muamalat, 2021, p. 80). The bank also actively developed the VBIAF Sectoral Guide covering oil and gas, construction, infrastructure, and manufacturing sectors (Bank Muamalat, 2022, p. 90).</p>
Reporting of VBI initiatives	<p>Bank Muamalat published its first Sustainability Report in 2017. The report adheres to the Integrated Reporting Framework, the Global Reporting Initiatives (GRI) Sustainability Reporting Standards, and Bursa Malaysia's Main Market Listing Requirements and Sustainability Reporting Guide.</p>

Tables 1 to 4 capture IBs' initiatives on VBI: intention disclosures, implementation strategies, offerings and services in line with the underpinning thrusts, and reporting. As illustrated in Tables 1 to 4, the IBs have introduced various offerings and services contributing to the different SDGs, guided by both the underpinning thrusts of entrepreneurial mindset and community empowerment. For example, the thrust of an entrepreneurial mindset facilitates the IBs to develop offerings contributing to SDG 8, which relates to the growth of micro, small, and medium-sized enterprises through the provision of financial services. The offerings also support SDG 9 on promoting access to financial services for small-scale industrial and other types of enterprises, including affordable credit, to build sustainable and resilient infrastructures to support economic development and human well-being. Moreover, these IBs initiatives will address all the other SDGs

relating to enhancing the well-being of the people under SDGs 1 – 5, increasing job opportunities, and supporting livelihood under SDG 8.

The initiatives undertaken by the IBs under the community empowerment thrust, on the other hand, support the various SDGs on enhancing the quality of life. This includes SDG 1 on eradicating poverty, such as ensuring that everyone, in particular the poor, has access to economic resources and appropriate financial services to assist them in getting out of poverty, SDG 3 on ensuring healthy lives and the promotion of the well-being of the people at all ages, and SDG 4 which calls for inclusive and equitable education quality for all people.

Under the VBI underpinning thrust of best conduct, IBs engage with stakeholders to understand their needs and how the bank can meet these needs and expectations. Following the VBI underpinning thrust of good governance, IBs develop governance structures for the VBI implementation. Note that these practices and operations adopted by the IBs support IBs' commitment towards the VBI in furtherance of the realisation of the SDGs.

It can also be observed from Tables 1 to 4 that all IBs disclosed their VBI adoption intention and reported their VBI initiatives to facilitate stakeholder activism in ensuring that the IBs perform according to their VBI strategic plans.

To deliver the intended outcome of Shariah, the VBI guides the IBs in changing their entire business model, operations, practices, and approach to create positive impacts on the environment, society, and economy by supporting the SDGs. The initiatives in Tables 1 to 4 have illustrated how all IBs adopted the VBI to realise SDGs beyond corporate social responsibilities. In one study, the researchers were of the view that prior to VBI, IBs were at a disadvantage as there was no proper framework or guidelines for IBs to achieve the objectives of Shariah other than the banks' own understanding of the objectives of Shariah (Syed Alwi et al., 2021(b); Syed Alwi et al., 2021(b)). Hence, with the VBI, a proper framework is available to guide IBs in this direction and to support the SDGs.

## **VBIAF**

Besides changing the offerings and services, the VBI adoption entails IBs changing their practices and operations (Bank Negara Malaysia, 2018). This change involves a risk assessment and management integrating environmental and social considerations. To assist the IBs in this direction, BNM issued the guidance document on the VBIAF. However, the VBIAF requires IBs to establish the following:

- i) To identify and categorise negative and positive impacts of the IB's financing or investment activities (Impact-based risk identification) (Bank Negara Malaysia, 2019, p. 24);
- ii) An approach for complete and accurate understanding and measurement of impact-based risk associated with the financing and investment activities (Impact-based risk measurement) (Bank Negara Malaysia, 2019, p. 31);
- iii) A comprehensive impact-based risk management and mitigation strategy (Bank Negara Malaysia, 2019, p. 36); and
- iv) A robust impact-based risk monitoring and reporting (Bank Negara Malaysia, 2019, p. 38).

## **Impact-based risk identification**

Impact-based risk identification allows the IB to identify the negative impacts of a financing or investment activity that requires mitigation. It also enables the IB to determine the appropriate risk management tool to mitigate adverse effects (Bank Negara Malaysia, 2019, p. 24). For purposes of identifying and categorising the impact of a financing or investment activity, the guidance document on the VBIAF provides that IBs should develop tools and methodologies to understand if a customer in a particular industry is at risk of causing detrimental impacts (Bank Negara Malaysia, 2019, p. 25). It should also develop sector and issue-specific policies to clearly state the requirements of the IB for customer performance (Bank Negara Malaysia, 2019, p. 27); identify

during the customer on-boarding process gaps in the customer performance against the IB's sector and issue-specific policies (Bank Negara Malaysia, 2019, p. 28); and develop an exclusion list of projects which the IB should not finance or invest. Such projects can be projects that cause biodiversity loss or pollution.

### **Impact-based risk measurement**

Following the impact-based risk identification, the IB must develop a mechanism to measure the impact-based risk associated with the financing and investment activities. For this purpose, assessment occurs at the customer<sup>8</sup> and transaction<sup>9</sup> levels. The IB then must assign a risk level or score to the customer based on the assessment results. The scale of the scores ranges from unacceptable, high, medium, and low risks (Bank Negara Malaysia, 2019, p. 33).

### **Impact-based risk management and mitigation strategy**

Based on the risk level or score assigned to the customer, the IB identifies conditions for approval, any covenants that the customer needs to abide by, and possible imposition of penalties in a non-compliance case. The guiding document on the VBIAF also states that the IB needs to develop a robust customer-nurturing strategy. This aims to effectively assist the customer in adopting and enhancing its sustainability practices and deter them from failing to comply with the IB's impact-based terms and conditions. IBs should also consider an effective exit mechanism if the customer fails to meet the terms and conditions, abide by the covenant, or adhere to remedial action plans within the customer's control (Bank Negara Malaysia, 2019, p. 37).

### **Impact-based risk monitoring and reporting**

Finally, IBs should establish a monitoring and reporting process to identify changes in impact-based risk and to ensure timely escalation of the changes to its Board of Directors and senior management (Bank Negara Malaysia, 2019). This process allows the IB to monitor the customer to identify early signs of deteriorating or increasing negative impact. In addition, IBs are also to monitor new developments in industries for impact-based risks. In reporting, IBs are to establish policies and procedures for impact-based risk reporting to meet the needs of different groups of report users.

The mentioned requirements suggest that the VBIAF provides a framework for IBs to incorporate ESG considerations in its provision of financing and investment activities. It involves a considerable change in IBs approach to risk management. Furthermore, IBs extend the risk assessment to include how the financing and investment activities impact the economy, community, and environment. As such, the VBIAF adoption allows IBs to understand their risks comprehensively and the impact of their financing and investment activities. By adopting the VBIAF framework, IBs will not finance or invest in projects under their exclusion list. IBs will also not finance or invest in projects that can cause irreversible negative environmental and social impacts, with no mitigation actions taken or developed to prevent the negative impact. Moreover, IBs will not finance and invest in customers with no management procedures to mitigate environmental and social risk, no reporting mechanism on performance, or no willingness and commitment to improving irreversible environmental and social issues. Besides refraining from funding and investing in unsustainable projects, IBs have a more involved role in directing their customers towards sustainable practices, as they should nurture their customers in that direction. Thus, the VBIAF allows IBs to make a more informed decision to direct their funding and investment to businesses and transactions that support SDGs and steer businesses towards

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<sup>8</sup> At customer level the client is assess on the client's ability to meet the requirements of the IBI's sector and issue specific policies by examining the client's present commitment, capacity, and track record (Bank Negara Malaysia, 2019, p. 31).

<sup>9</sup> Assessment at transaction level is where the financing and investment activity is assessed for its positive and negative impact on the environment and community (Bank Negara Malaysia, 2019, p. 32).

practices and operations that support SDGs. Table 5 elaborates on the IBs' assessment measures for adopting the VBIAF or similar ESG risk framework.

**Table 5:** Adoption of VBIAF or similar ESG risk framework by Bank Islam, HSBC Amanah, and Bank Muamalat

Bank Islam	<p><u>VBI Checklist as preliminary assessment for financing.</u>  Since 2018, the business units of the bank have utilised a VBI checklist for preliminary assessment for financing and also for annual review of existing financing. The VBI checklist assessment covers broad compliance by business activities on matters such as Shariah-compliant, environmental protection and minimisation of negative environmental impact, positive social impact, and corporate governance (Bank Islam Malaysia Berhad, 2021b, p. 110) (Bank Islam Malaysia Berhad, 2022a, p. 147). This assessment is used as a preliminary guide in the credit assessment and evaluation process (Bank Islam Malaysia Berhad, 2022a, p. 147).</p> <p><u>ESG and climate assessment on business financing applications</u>  In 2022, the bank initiated ESG and climate assessments of business financing applications at the onboarding stage to determine environmental, social, and governance risks in new and existing customers. In the same year, Bank Islam launched its ESG Risk Management Framework, which is still under development (Bank Islam Malaysia Berhad, 2022b) (Bank Islam Malaysia Berhad, 2022a, p. 111) and developed an ESG Scorecard to embed climate risk in its portfolio risk assessments (Bank Islam Malaysia Berhad, 2022a, p. 110).</p> <p><u>ESG and climate assessment on non-retail customers</u>  In 2022, the bank also incorporated climate and ESG risks into the credit rating of non-retail customers. A customer's credit rating is determined by not only all relevant credit factors but also ESG considerations and sector-specific risk factors. This is performed by assessing environmental, social, and governance risks through the ESG credit impact score. The ESG credit impact score and the customer's CCPT classification reflect the ESG impact on the non-retail portfolio (Bank Islam Malaysia Berhad, 2022a, p. 150).</p> <p><u>Sectors with high environmental or social risks.</u>  Bank Islam also undertakes ESG due diligence on key sectors identified as having high environmental and social risks. These sectors include large-scale agriculture, oil and gas, forestry, large-scale manufacturing projects, large-scale residential and industrial developments, mining, and quarrying (Bank Islam Malaysia Berhad, 2021b, p. 116).</p> <p><u>Sector guidelines</u>  The bank is in the process of developing detailed sector guidelines and assessment criteria for all sectors it is exposed to. The bank is spearheading the VBIAF sectoral guide on waste management (Bank Islam Malaysia Berhad, 2022a).</p> <p><u>Green financing portfolio</u>  For FY2022, Bank Islam's green financing portfolio amounts to RM2.9 billion, covering renewable energy and green building (Bank Islam Malaysia Berhad, 2022a, p. 22).</p>
HSBC Amanah	<p>To manage sustainability risk, HSBC Amanah incorporates impact-based risk assessment and management based on HSBC's Group Sustainability Risk Policies. The policies focus on sensitive sectors that have a high adverse impact on people or the environment (HSBC Amanah Malaysia Berhad, 2019, p. 43). The policies comprise the Agriculture Commodities Policy, Chemical Industry Policy, Energy</p>

	<p>Policy, Forestry Policy, Mining and Metal Policy, Thermal Coal Phase Out Policy and World Heritage Sites, and Ramsar Wetlands Policy (HSBC, 2022a). Assessment is conducted on both the customer and its business activities and is given a rating as follows:</p> <ul style="list-style-type: none"> <li>• Business activities that fall under the policies are assessed based on their impact on people or the environment and are given a Sustainability Risk Rating of High, Medium, or Low.</li> <li>• The customer is assessed based on whether it meets the standards under the relevant HSBC Group Sustainability Risk Policies and is given a Sustainable Risk Rating of Leader for exceeding the standards, Compliant for meeting the standards, Near-compliant for being on a credible path towards the standards but without unacceptable impacts; and Non-compliant for not materially meeting the standards.</li> </ul> <p>The bank does not enter into a business relationship with Non-compliant customers (HSBC, 2022a). The HSBC Group Sustainability Risk policies preclude HSBC Amanah from financing illegal logging and deforestation by customers involved in agricultural commodities and forestry (HSBC Amanah Malaysia Berhad, 2021b, p. 30).</p>
Bank Muamalat	<p><u>Disbursement towards VBI-aligned portfolio</u></p> <p>For 2022, Bank Muamalat disbursed a total of RM4,377.4 million to VBI sectors. The VBI-aligned portfolio consisted of sectors relating to the preservation of the natural environment (RM268 million), raising the community standard of living (RM2,316.3 million), promoting healthy lifestyle (RM300.7 million), education (RM152.6 million), health (RM520.8 million) and for SMEs (RM779.0 million) supporting the SDGs (Bank Muamalat, 2022, p. 90).</p> <p>However, its sustainability approach does not disclose whether Bank Muamalat adopted VBIAF or a similar framework in assessing its financing and investment activities.</p>

## CCPT

The CCPT provides a robust and consistent assessment of the provision of financing, investment, and advisory activities by FIs (economic activity) and how they impact the climate. It applies to all FIs supervised by BNM, including IBs (Bank Negara Malaysia, 2021). Whilst the VBIAF lays the foundation for ESG consideration in providing financial and related advisory services and investment of FIs supervised by BNM, the CCPT assists FIs in channelling capital and funds to businesses and economic activities that address climate change. Under the CCPT, customer economic activity and overall business are assessed based on the CCPT guiding principle. This criterion is unique among existing taxonomies in the world (Pfaff et al., 2021).

### The Guiding Principles under CCPT

The CCPT has five guiding principles. The first two principles are climate change mitigation (GP1) and climate change adaptation (GP2) to assess economic activity. The assessment of GP1 and GP2 occurs upon providing and extending financing, investment in financial assets, and structuring capital market transactions. The third guiding principle on no significant harm to the environment (GP3) and the fifth guiding principle on prohibited activities (GP5) assess customer economic activity and overall business. The fourth guiding principle on remedial measures (GP4) is to evaluate customer remedial efforts. Thus, the CCPT specifically addresses SDG 13, which calls for urgent actions to combat climate change and its impact. The following paragraphs elaborates on the guiding principles:



### **GP1: Climate change mitigation**

GP1 assesses whether the economic activity substantially contributes to avoiding GHG emissions, reducing GHG emissions, or enabling others to avoid or reduce GHG emissions. The CPPT explains that “substantial contribution” means that the positive impact of the activities should not be negligible and must be material enough to avoid potential greenwashing.<sup>10</sup> Although the CCPT provides this guidance, FIs can determine what is negligible or otherwise and what is material enough to avoid potential greenwashing. The economic activity must also not cause a significant negative impact on the broader environment. Similarly, what amounts to a significant negative impact on the broader environment is left to the FIs to determine.

### **GP2: Climate change adaptation**

GP2 assesses whether an economic activity positively contributes to a reduction in material physical climate risk and is sustainable. As mentioned earlier, FIs can determine what they regard as material physical climate risk. The assessment of the economic activity includes no negative impact on other adaptation efforts or no harm to the broader environment and community. The economic activity should also have climate change adaptation outcomes that can be clearly defined, observable, measurable, and monitored over time against pre-determined indicators.

### **GP3: No significant harm to the environment**

Under this guiding principle, the economic activity and the overall business are assessed to determine that they do not cause unintended harm to the broader environment. This is by supporting the environmental objectives under the Environmental Quality Act 1974 and National Policy on the Environment 2002. These aim to prevent, reduce, and control air, water, and land pollution, protect healthy ecosystems and biodiversity, and use energy, water, and other natural resources sustainably and efficiently.

### **GP4: remedial measures to transition**

Under this principle, FIs should encourage, facilitate, and capture the remedial efforts and improvement measures that businesses take to ensure the alignment of their operations with a low-carbon and climate-resilient economy. Therefore, instead of directly rejecting economic activities that do not support climate and sustainable objectives, FIs may enter into such economic activities where the customer demonstrates that they have corrective actions or improvement programmes towards low carbon and sustainable practices. Adequate assessments are to be conducted by the FIs to ascertain the significance and effects of the corrective actions and improvement programmes.

### **GP5: Prohibited activities**

Under GP5, FIs should verify and ensure that the economic activities that they are considering are not illegal and do not contravene environmental laws. Consistent with the VBIAF, FIs are also strongly encouraged to ascertain if the businesses are engaged in activities that contravene national human rights and labour laws.

### **Classification of economic activities (Bank Negara Malaysia, 2021, p. 24)**

Based on the assessment conducted on the customer economic activity and overall business, the economic activity is then classified under three broad categories: climate supporting, transitioning, or watchlist, depending on its contribution towards climate and environmental objectives. Under these broad categories, the economic activity is further placed under different levels (C1 – C5)

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<sup>10</sup> An entity is considered to be involved in “greenwashing” when it partakes in practices that are intended to create an impression that would result in the entity receiving a more than favourable perception about its environmental impact. (Bank Negara Malaysia, 2019, p. 40 footnote 70)

based on whether a remedial measure is required and whether the customer has put the remedial measures in place, if necessary.

Economic activity will be classified as climate supporting (C1), where the economic activity contributes to climate change mitigation or adaptation, and both the economic activity and overall business do not cause significant harm to the broader environment.

Suppose the economic activity contributes to climate change mitigation and climate change adaptation or climate change mitigation or climate change adaptation; however, the overall business of the customer causes significant harm to the broader environment. In that case, the customer is assessed on whether its business has taken remedial measures to promote the transition to low-carbon and sustainable practices and reduce harmful practices. Meanwhile, where the business has taken remedial measures, then it is classified as transitioning (C2). If the business has not taken remedial measures, it is then placed under the watchlist (C4).

An economic activity that does not contribute to climate change mitigation and climate change adaptation or both and the economic activity and overall business of the customer causes significant harm to the environment; however, remedial efforts to reduce the harmful practices are taken by the customer fall under transitioning (C3). Where the business does not commit to remedy and reduce the harmful practices, it falls under the watchlist (C5).

The CCPT expects FIs to constructively engage customers under watchlists C4 and C5 to encourage these customers to develop concrete, actionable plans to address the identified harm to the environment. However, suppose these customers fail to demonstrate commitment to implementing any remedial efforts or reduce the harm caused by the economic activity. In that case, FIs can impose more stringent conditions on the financing, including reassessing the business relationship with the customer with a view to exiting.

The elaboration suggests that the CCPT facilitates FIs to channel funds toward activities and businesses that support climate objectives and sustainable practices. The CCPT adoption by FIs will also drive businesses to align their strategies and operations towards sustainable practices. Table 6 elaborates on the measures by Bank Islam, HSBC Amanah, and Bank Muamalat to adopt CCPT or other climate change taxonomy.

**Table 6:** Adoption of CCPT or other climate change taxonomy by Bank Islam, HSBC Amanah, and Bank Muamalat

Bank Islam	<p>In 2022, Bank Islam fully implemented the CCPT to understand its portfolio’s exposure to climate impacts and risks. It assesses climate risk on corporate, commercial, and SME financing as well as retail financing. Assessment of climate risk is conducted at the transaction level and entity level (Bank Islam Malaysia Berhad, 2021b, p. 120).</p> <p><u>CCPT assessment at the transaction level</u> Assessment at the transaction level comprises due diligence of the potential use of proceeds of a new or existing financing facility. It is, however, unclear how far back existing financing facilities are being assessed for their climate risk. From the assessment, the use of the proceeds may be categorised based on the appropriate GP under the CCPT.</p> <p><u>CCPT assessment at the entity level</u> An entity-level assessment includes an overall assessment of the customer’s sustainability policies, action plans, implementation of sustainability roadmaps, and issues or incidents related to ESG. The assessment is conducted based on industry-specific norms and standards, especially pertaining to certification (Bank Islam Malaysia Berhad, 2021b, p. 121). Based on the assessment, the bank can understand the climate risk of the customer and any remedial activities performed by the customer.</p>
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	<p>Bank Islam had committed to phasing out and ending the financing of coal-related activities by 2030 (Bank Islam Malaysia Berhad, 2021b, p. 117).</p>
<p>HSBC Amanah</p>	<p>HSBC's Amanah's climate-related strategies are aligned with HSBC's Group ambition to become a net zero bank by 2030 in its operations and supply chain and by 2050 net zero financed emissions (HSBC Amanah Malaysia Berhad, 2021b, p. 11). To manage its climate risk, HSBC Amanah adopts the HSBC Group-wide risk management framework and the three lines of defence model in identifying, assessing, and managing its climate-related risk (HSBC Amanah Malaysia Berhad, 2022b, p. 20). Material climate-related risk issues are presented in the Risk Management governance meeting chaired by the Chief Risk Officer in the presence of members of the Executive Committee. The issues discussed are then brought before the BRC for its oversight (HSBC Amanah Malaysia Berhad, 2021b, p. 30).</p> <p>HSBC Amanah has identified six key sectors where its wholesale credit customers have the highest climate risk, which are oil and gas, construction and building materials, chemicals, automotive, power and utilities, and metals and mining (HSBC Amanah Malaysia Bhd, 2020a, p. 23). The customers in these sectors are continuously engaged, and transition risk questionnaires are administered to its largest customers in these high-risk sectors to understand the impact of climate change on their business models and related transition strategies. This allows HSBC Amanah to assess the customers' needs and readiness to adapt and identify potential business opportunities, supporting HSBC Amanah's decision-making and credit risk management processes. Support by HSBC Amanah is then provided through transitioning financing (HSBC Amanah Malaysia Berhad, 2021b, p. 21).</p> <p>HSBC Group has set a target to mobilise between USD 750 billion and USD 1 trillion of sustainable finance and investments by 2030 to assist its customers in transitioning to net zero and sustainable practices. In 2022, HSBC Amanah contributed RM1,274 million to this end through sustainable finance (HSBC Amanah Malaysia Berhad, 2022b, p. 25).</p> <p>With the announcement by HSBC Group in December 2021 that it will phase out financing of coal-fired power and thermal coal mining by 2030 in EU and OECD and by 2040 in other markets, HSBC Amanah, under its Thermal Coal Phase Out Policy, will not provide new financing to:</p> <ul style="list-style-type: none"> <li>• Any activities that are incompatible with HSBC's net zero transition by 2050 target;</li> <li>• Any customer that declines to engage sufficiently on its transition plan, or where the plan is determined to be incompatible with HSBC's net zero transition by 2050 target, or</li> <li>• Prospective customers with significant thermal coal power capacity, mining production, or revenues, except to materially reduce greenhouse gas emissions (HSBC Amanah Malaysia Berhad, 2021b, p. 30).</li> </ul> <p>In 2020, HSBC issued its first disclosure on climate-related risk report in accordance with the Financial Stability Board's (FSB) TCFD recommendation.</p> <p>In 2021, HSBC reported that consistent with the requirements of the CCPT on reporting climate-related exposures, HSBC Amanah was designing a questionnaire to assess the contribution of its financing and related services and investment activities towards climate and environmental objectives (HSBC Amanah Malaysia Berhad, 2021b, p. 34).</p>

Bank Muamalat	<p>In 2021, the bank reports that it plans to review its risk management framework to include climate-related risks and to embed climate-related objectives in the overall banking process and operations (Bank Muamalat, 2021, p. 93).</p> <p>In 2022, the bank began incorporating CCPT classification in the financial assessment for non-retail financing applications and implemented climate change scoring for all financing applications (Bank Muamalat, 2022, p. 94).</p>
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The findings above illustrate how Bank Islam, HSBC Amanah, and Bank Muamalat's business model, practices, and operations have transitioned from the traditional financial intermediation that focuses on creating profits for shareholders to financial intermediation, creating positive socio-economic and environmental impacts whilst generating profits. This transition is apparent from the banks' disclosure of the VBI adoption. Following the adoption, all three banks have formulated the VBI implementation strategies and KPIs to measure their VBI-related performance.

Guided by the VBI principle thrust of an entrepreneurial mindset and community empowerment, the IBs introduced new products and services. They also undertook various social finance initiatives to facilitate entrepreneurial activities and empower communities in support of realising SDGs 1 – 6 and 8. All three banks have also allocated and disbursed financing focusing on green financing and ESG-aligned sectors, such as renewable energy and environmentally responsible businesses supporting the SDGs related to environment protection and preservation.

To determine how their business, operations, and practices can contribute positively to the community and the environment in support of the SDGs, the banks conduct regular stakeholder engagement consistent with the VBI underpinning thrust of good governance. However, from the publicly available documents studied, none of the banks revealed that they have a formal stakeholder engagement policy. All three banks, however, have a clear sustainable governance structure and a designated centre, department, or office to manage all their social finance and sustainable initiatives.

One of the roles of FIs in supporting the SDGs is to direct funds to businesses or projects that support SDGs 1-15 on improving human life and well-being and environment protection and conservation, including addressing climate change and its negative impacts. Bank Islam recently launched its ESG Risk Framework to manage its sustainability risk in 2022. However, the ESG Risk Framework is still being developed. Nonetheless, Bank Islam has initiated ESG and climate assessment on its business financing applications and non-retail customers. Conversely, to manage its sustainability risk, HSBC Amanah adopts the existing HSBC Group Sustainability Risk Policies to assess the impact of its business customers and activities on people or the environment. Bank Muamalat reports that its new financing is within the VBI parameters towards positive ESS outcomes. Note that Bank Muamalat's sustainable approach does not reveal whether it adopts the VBIAF or other similar frameworks.

For specific sectoral policies for environment and social risk management, HSBC Amanah has specific sectoral policies through the adoption of HSBC's Group Sustainability Risk Policies. It is unclear whether Bank Islam and Bank Muamalat adopt the VBIAF Sectoral guides in assessing their financing and investments. Thus, although VBI-related initiatives are fairly advanced within the three banks, adopting the VBIAF or a similar framework is still in its developing stages for Bank Islam. However, Bank Muamalat has not disclosed the existence of such a framework in its operations.

Stakeholder activism plays a critical role in supporting the VBI. As such, disclosures by the banks on their VBI initiatives are vital. Hence, all the banks disclosed their VBI initiatives in stand-alone reports or integrated annual reports. Two banks referred to established international sustainability reporting standards, such as the GRI and the International Integrated Reporting (IIR).

SDG 13 is on combating the negative impacts of climate change. To align its operations to SDG 13, Bank Islam fully adopted the GP under CCPT, with climate risk assessed at transactional and entity levels in 2022. HSBC Amanah adopts its existing HSBC Group-wide Risk Management Framework in assessing climate-related risk. In 2022, Bank Muamalat began incorporating the CCPT classification in its financial assessment for non-retail financing applications and implemented climate change scoring for all financing applications.

In reporting on climate-related financial disclosures, HSBC Amanah is designing a questionnaire to assess the contribution of its financing and related services and investment activities towards climate and environmental objectives, consistent with the reporting requirements of the CCPT. Note that Bank Islam has only recently disclosed in line with the CCPT classification system. Except for HSBC Amanah, neither Bank Islam nor Bank Muamalat have made any climate-related financial disclosures per the TCFD recommendations and recommended disclosures. Out of the three banks studied, only Bank Islam and HSBC Amanah have specific climate-related targets.

From the above observation, addressing climate objectives and the CCPT adoption are still at the initial stages by the three banks compared to their progress in VBI initiatives. Table 7 below summarises the changes in business models, practices, and operations of the three IBs following BNM's issuance of the VBI, VBIAF, and CCPT.

**Table 7:** Summary of the business model, practices, and operations of Bank Islam, HSBC Amanah, and Bank Muamalat following BNM's issuance of VBI, VBIAF, and CCPT

	<b>Bank Islam</b>	<b>HSBC Amanah</b>	<b>Bank Muamalat</b>
Disclosure by the banks of its intention to adopt VBI	√	√	√
Formulation of implementation strategies for VBI and development of KPIs to measure VBI progress	√	√	√
Introduction of offerings in line with the underpinning thrust of entrepreneurial mindset.	√	√	√
Introduction of offerings in line with the underpinning thrust of community empowerment.	√	√	√
Inculcation of practices consistent with the underpinning thrust of good self-governance.	Sustainability governance structure established. The Centre of Social Finance was established to manage all its social finance initiatives.	Sustainability governance structure established. Cocoon PMO is in charge of all sustainability initiatives.	A clear sustainability governance structure was established, with the Social Finance Department mandated to manage all social finance initiatives. Bank Muamalat became the 1 <sup>st</sup> IB to be a member of GABV.
Inculcation of practices consistent with the	Conducts stakeholder engagement.	Conducts stakeholder engagement.	Conducts stakeholder engagement.

underpinning thrust of best conduct.			
Adoption of VBIAF or similar environment and social risk assessment and management.	The ESG Risk Management Framework was launched in 2022 and is being developed.	Adoption of HSBC Group Sustainability Risk Policies.	New financing by the banks is extended within VBI parameters towards a positive environment and social outcomes. However, the bank's sustainability approach does not disclose the adoption of VBIAF or similar E&S risk assessment and management.
Introduction of specific sectoral environment and social risk assessment and management.	In the process of introducing specific sectoral risk assessment and management.	√	-
Reporting of VBI initiatives.	VBI initiatives are reported in the bank's Integrated Annual Reports. Bank Islam also has a separate report on its Centre of Social Finance activities.	The first VBI Disclosure Report was released in 2019. VBI initiatives are also reported in its climate-related risk financial disclosure reports.	Reported in the bank's Annual Reports
Adoption of CCPT or similar climate change taxonomy.	Bank Islam has fully adopted the CCPT in 2022.	HSBC Amanah adopts the HSBC Group-wide Risk Management Framework to manage its climate risk.	In 2022, CCPT classification was incorporated in the financial assessment for non-retail financing applications, and climate change scoring was implemented for all financing applications.
Commitment to specific climate-related targets	Phase out and end financing of coal-related activities by 2030.	A net zero bank by 2030 in its operations and supply chain and by 2050 in its financed emission.	-
Reporting of climate-related exposure under CCPT	√	In the process	-
Reporting of climate-related financial disclosure in accordance with the FSB's TCFD recommendations	-	√	-

## **CONCLUSION**

In conclusion, Malaysia's sustainable banking regulatory frameworks have influenced the three selected IBs to change their offerings, practices, and operations. All three IBs have placed much effort into VBI-related initiatives in line with the four VBI underpinning thrusts and the strategies suggested in the Strategy Paper on the VBI. Thus, these VBI-related initiatives and changes in operations and practices by the IBs can support the SDGs.

The three banks, however, are at different stages in adopting social and environment risk assessment and management. However, HSBC Amanah has already adopted its Group Sustainability Risk Policies with specific sectoral risk assessment and management. Meanwhile, Bank Islam has only recently launched its ESG Risk Management Framework, which is being developed and is in the process of developing its sectoral risk assessment and management. On the other hand, Bank Muamalat has not revealed an ESG Framework under its sustainability approach. Nevertheless, it states that its new financings are extended toward positive environment and social outcomes. Since social and environment risk assessment and management plays a critical role in facilitating IBs to direct funds to sustainable projects and businesses and compelling businesses to adopt sustainable practices, the development and adoption of a social and environment risk assessment and management, such as the VBIAF, will be a critical improvement area for the IBs in their support of the SDGs.

Similarly, all three IBs studied are at different stages of CCPT adoption. Bank Islam has recently fully adopted the CCPT. Bank Muamalat has recently incorporated it in the financial assessment for non-retail financing applications and implemented climate change scoring for all financing applications. Conversely, HSBC Amanah assesses its climate risk based on the HSBC Group-wide risk management framework.

For climate-related exposure disclosures, Bank Islam has recently made its disclosure in line with the CCPT classification system. HSBC Amanah is currently designing a questionnaire to assess the contribution of its financing, related services, and investment activities towards climate and the environment, consistent with the requirements of the CCPT. Furthermore, the documents studied for Bank Muamalat do not indicate whether the bank has made its disclosure as required under the CCPT. Out of the three banks, only HSBC Amanah has issued its climate-related financial disclosures in line with the TCFD recommendations, which the bank has conducted since 2020. HSBC Amanah's measure is commendable as it is way ahead of the period for mandatory TCFD disclosures on all FIs in Malaysia from 2024 onwards.

SDG 13 urges governments to take urgent steps to combat climate change and its impacts. Climate-related risks in the form of physical and transitional risks can be transmitted to IBs. The Malaysian government has also pledged to increase GHG emission reductions to 45% by 2030 and become a carbon-neutral nation as early as 2050. Considering all these matters, the adoption by the IBs of a taxonomy to assess the financing, advisory services, and investment of IBs and the extent to which these activities meet climate objectives and promote the transition to a low-carbon economy will be paramount. Furthermore, the requirement for reporting under the CCPT and the requirement mandated on all FIs to make TCFD disclosures from 2024 onwards also means that IBs must increase efforts to operationalise CCPT. Where CCPT or similar taxonomy has been adopted by IBs, the effectiveness and relevancy of the taxonomy must continuously be assessed as climate-related risks are dynamic and constantly evolving.

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