

29 September 2022

By online submission

Attn:

Ms. Razeen Mohd Rom

Mr. Muhamad Shukri Abdul Rani

Ms. Lim Sheng Ling

Mr. Muhammad Syamil Kamaruzzaman

Bank Negara Malaysia

Bangunan Bank Negara Malaysia,

Jalan Dato Onn,

50480 Kuala Lumpur.

ASIFMA Response to the BNM 2024 Climate Risk Stress Testing Discussion Paper

The Asia Securities Industry and Financial Markets Association (“ASIFMA”)¹, on behalf of its members (“the Industry”) appreciates the opportunity to provide feedback on the 2024 Climate Risk Stress Testing Discussion Paper (“the Discussion Paper”) from Bank Negara Malaysia (“BNM”). ASIFMA welcomes this discussion paper’s guidance which reflects BNM’s leadership and commitment towards climate risk measurement and reporting and efforts to align with internationally agreed approaches.

General Comments

ASIFMA commends the alignment BNM has achieved between the proposed Climate Risk Stress Testing (CRST) with the principles laid out by other international players including in terms of data requirements and the alignment with scenarios developed by the Network of Central Banks and Supervisors for Greening the Financial System (“NGFS”). ASIFMA and its member firms also appreciate that BNM has specifically stated that the stress testing outcome will not be used for direct calibration of banks’ capital requirements, which we believe rightly reflects other international supervisory practises and the state of preparedness within the industry and the wider economy.

Level of Preparedness, Data Availability and Disclosure Guidelines

ASIFMA believes that the industry is still at a nascent stage with regards to its capability to quantify and assess climate risk exposures. Members have expressed concerns over the date for the stress test to take place, as this may not provide members sufficient time to implement the necessary foundations to ensure a successful test. Some of the specific concerns is that it will take time to develop appropriate knowledge and build capacity, identify meaningful and accurate data points and infrastructure, and lastly develop sophisticated models to accurately assess climate related risk. In addition, international corporations with

¹ ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive, and efficient Asian capital markets that are necessary to support the region’s economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

a presence in the Malaysian market may not yet have the data and internal capabilities to conduct assessments at a granular and location specific level, again this may take time to develop and implement in order to meet BNM testing requirements.

Acknowledging that there has been significant progress and awareness on the importance of data in the quantification of climate-related risks, the process is still ongoing and therefore we believe that it would be more appropriate for BNM to continue providing guidance for standardized local data sources that can be leveraged for the CRST exercise.

Members are concerned that without clear guidance from BNM to institutions participating in this exercise, it may fail to provide meaningful information on the resiliency of financial institutions against physical and transition risks arising from various climate scenarios. To enhance communication and effectiveness of this exercise, we suggest BNM could consider holding regular workshops throughout the duration of the exercise – e.g., workshops to provide guidance on counterparty level assessment and approaches to reflect mitigation and adaption plans.

Alignment with the Climate Change and Principle-based Taxonomy (“CCPT”)

ASIFMA notes that within the Discussion Paper, the CCPT was referenced in relation to the use in counterparty-level assessment for banks. As such, the Industry would like to seek further details on how BNM envisage the CCPT to interface with CRST, and how it can be applied as a benchmark on levels of climate resilience of counterparties.

Capacity Building and Community Driven Initiatives

Members are seeking BNM’s expertise in providing support for capacity and capability building within institutions. In a similar example, the Cross Agency Steering Group in Hong Kong do provide support in the form of seminars, training, and data to aid the implementation of climate risk stress testing exercises. Within the Malaysian context, the Joint Committee on Climate Change (“JC3”), could potentially deliver knowledge sharing exercises to participants.

Timeline and Submission Requirements

As mentioned above, ASIFMA believes that a 2-year lead time for the 2024 CRST exercise would be challenging. Furthermore, as climate risk disclosure guidelines are expected to come into effect in 2024 (based on the current market progression), we urge BNM to consider conducting the CRST exercise during 2025 or after the first set of disclosures are reported, to allow for a more meaningful and accurate CRST exercise. This would allow banks to apply less internal judgement on matters such as counterparty climate risks, resulting in a more standardised stress testing exercise across Banks. ASIFMA further urges BNM to outline future potential expectations of CRST to allow institutions to be better prepared for subsequent exercises.

In the following section we provide responses to some of the specific questions raised in the Discussion Paper.

Our response has been drafted with the support of our professional firm member Deloitte Business Advisory Sdn. Bhd. (formerly known as Deloitte Risk Advisory Sdn. Bhd.) (“Deloitte”), based on feedback from the wider ASIFMA membership. On the following enclosed pages, we provide specific responses to questions

posed within the Discussion Paper. We thank BNM for the opportunity to provide feedback and for considering our comments. We would be happy to meet and further discuss any of the issues raised and provide clarity on our response. Should you have any questions, please do not hesitate to contact me, Diana Parusheva (dparusheva@asifma.org), Head of Public Policy and Sustainable Finance at ASIFMA.

Sincerely,

A handwritten signature in black ink, appearing to read 'Diana Parusheva', with a stylized flourish at the end.

Diana Parusheva
Executive Director – Head of Public Policy and Sustainable Finance
Asia Securities Industry & Financial Markets Association (ASIFMA)

Detailed Responses

Section 4: Participation and Level of Applicability

Question 1: Are there any other factors that the Bank should consider when setting the scope of participation and level of applicability of the 2024 CRST exercise?

ASIFMA and its members have no further comment.

Question 2: What kind of challenges would your institution face in order to conduct the analysis on overseas operations' exposures?

We believe that the current reporting and disclosure requirements of the respective foreign markets in which the borrowers or customers are currently operating may differ from that set out by BNM in Malaysia and may pose difficulties for institutions within the Industry. Further to this, we believe that validating climate-related data, hazard maps or documentations that may be limited or unavailable in the foreign markets by 2024 may also pose challenges. Another challenge we would face would be the harmonization of climate risks in the form of carbon prices, capital expenditure, technological investments, wildfires within the region for businesses with operations in other jurisdictions. Additionally, the key challenge with expanding the CRST to cover non-Malaysian operations is the access to data to perform the relevant tests, added complexities with offshore operations, and ensuring the institutions can conduct the test at individual location levels.

Section 5: Scenario Narratives and Time Horizon

Question 3: Do the choice of scenarios, specifications and time horizon provide sufficient balance between allowing a full assessment of the climate-related risks while also being tractable for financial institutions' modelling capabilities?

We agree with BNM's use of globally consistent scenario (derived from NGFS Hot House World and Disorderly categories). However, as mentioned previously, the long-term time horizons could pose challenges especially when they are projected longer than a 5-year period. While having two separate scenarios from "hot house world" make sense, we would suggest BNM to consider the benefits of prescribing them as they are both broadly similar. Banks are currently relying on external vendors for asset level physical risk impacts, which are not yet proactive in adopting NGFS scenarios but rather following RCP scenarios. In practicality, many firms might use RCP 8.5 scenario results as a proxy to both "Hot house world" scenarios. We would appreciate for BNM to provide the counterfactual scenario variables for physical and transition risks given its usefulness when comparing the delta impact of climate risk compared to a world with no climate risk impacts.

Question 4: In selecting scenarios to capture the impact from transition risks, the Bank opted for the Delayed Transition scenario given its plausibility in Malaysia's context. Do you agree with this approach?

Given the current implementation of climate and ESG policies and practices such as the implementation of carbon pricing or taxes, controls on emissions, as well as investments into greener technology or energy in Malaysia, utilizing more extreme scenarios will be helpful as illustrators than 'midway' scenarios. Nonetheless, the Delayed Transition scenario will be helpful for modelling purposes because we would

never really know the speed of onset for such risks as climate impacts become more prominent as the world is not moving on track with orderly scenarios. As such, the delayed change scenario could be Malaysia's more aggressive transition scenario. Aside from this, there needs to be a clear understanding on the extent to which the downsizing on carbon prices will be and in the approach to which carbon prices in Malaysia would be benchmarked such as leveraging on the NGFS OSC data. This will allow for companies to set their risk appetites based on the Net Zero scenario as opposed to waiting till 2030. Aside from the above, by utilizing the Net Zero scenario, there can be better harmonization of climate scenarios between the local banks with that of the UK and United States which have aggressive climate targets and policies, allowing for a more robust benchmarking to be done.

Question 5: How relevant is the Divergent Net Zero scenario developed by NGFS, which assumes divergent policies across sectors, in Malaysia's context?

We believe that the Divergent Net Zero scenario may be somewhat relevant to the Malaysian context as Divergent Net Zero could be very close to reality as all countries/industries find their own pathways towards net zero, with different goals (timelines) noted for different countries/industries. However, we believe that the delayed scenario is more plausible and appropriate. Additionally, there would be differences when looking at a sectoral approach as there is an imbalance in the recent developments within the different sectors, and the sector level policies may also likely be delayed. For example, there have been no recent climate policies established for the mining industry, however, within the construction industry, there are various new certifications such as the GreenRE for newly developed residential properties.

Question 6: Is there sufficient differentiation between the Current Policies and NDCs scenarios in Malaysia's context to warrant using both Hot House World scenarios in the CRST exercise, or would one or the other suffice?

Please refer to our response above to Q3 with respect to the practicality of running physical risk intensive scenarios. In addition, current policies scenarios provide a realistic base case especially if an orderly and a disruptive scenario are modelled.

Question 7: Do you agree with the Bank's proposal to exclude orderly scenario(s) from the 2024 CRST exercise?

We do not agree with the proposal to exclude the orderly scenario(s) from the CRST exercise. While orderly scenario is unlikely to happen in Malaysia/the region, we must consider that foreign banks/international entities will want to work with countries/entities that considers scenarios that are aligned to international standards; as such, to consider orderly scenario could be systematically important for Malaysia. Aside from this, banks can slowly develop strategies from now with a soft-landing approach as opposed to having a delayed approach which would lead to an abrupt change. By including the orderly scenarios, local banks and ITOs will be also able to benchmark against European banks performance in these key areas.

In addition to this, orderly scenario should be considered as it provides a view of progressive and visionary policy making and provides an intermediate scenario between Current Policies and the disruptive transition. Furthermore, if this exercise plans to have any business strategy overlay, then the Orderly scenario will also be most useful.

Question 8: Beyond those proposed above, are there any other scenarios, informed by peer-reviewed research, that the Bank should consider?

We believe that there are other scenarios that BNM should consider such as IEA WEO, as data maturity grows further in this field. Furthermore, IEA WEO has key datasets that can be used for modelling purposes.

Question 9: Are there specific narratives or parameters relevant to Malaysia that the Bank should consider in refining the proposed climate scenarios beyond what has already been provided by the NGFS?

BNM could consider other socioeconomic and climate pathways, however, given the nascent state of climate related data availability in Malaysia, BNM should aim to strike a balance between comprehensiveness and practicality of including other complex narratives and parameters within the 2024 CRST exercise.

Question 10: Are the climate, macroeconomic and financial variables adequate in capturing the climate-related risks in the proposed scenarios, allowing for further scenario expansion, if any?

Our view is that the variables proposed in Table 1. Indicative Scenario Variables on page 10 of the discussion paper would not be sufficient for variable expansion and granular sectoral data would be required for institutions to conduct the stress test using a bottom-up analysis approach, including via an expanded variable set for carbon intensive sectors such as at minimum price, output, emissions for each sector. Macroeconomic variables for other key jurisdictions (EU, U.S., and China) should also be provided to aid the scenario expansion process. Alternatively, if the data availability is limited, then a simplified approach would need to be adopted.

Question 11: Are there any other external data sources that can be added to the current list in Appendix 4?

While the external data sources provided by BNM in the appendix of the discussion paper do provide global level climate data, we believe additional data from the Malaysian Meteorological Department and Irrigation Departments could assist some institution with information on river levels and other critical weather-related data. Aside from this, we believe that the Inter-Sectoral Impact Model Intercomparison Project (“ISIMIP”) data catalogue should also be included within the current list in Appendix 4. Aside from this, the following list of data sources could also be considered by BNM: -

- Moody’s ESG Rating;
- Refinitiv ESG Score;
- Bloomberg ESG Data;
- Moody’s 427 Climate Data;
- CDP;
- Trucost; and
- Sustainalytics.

Question 12: Would the proposed assessment horizon (i.e. 30 years) adequately capture the impact of climate-related risks on financial institutions?

There are potential challenges faced by institutions when assessment horizons are extended beyond a 5-year period, which mainly include challenges in projecting balance sheet growth and other metrics (e.g., Probability of Default). Exercise participants would benefit from BNM's guidance on long-term scenario analysis and business strategy assumptions.

Question 13: Do you agree with the Bank's proposal to bring forward the materialization of physical risks (expected in the second half of the century) into the CRST time horizon?

We agree with the proposal as the impact of physical risk should manifest itself significantly onto the credit risk and market risk of a bank within the span of a 30-year time horizon, not considering any significant improvement to technology to reverse or mitigate this impact, with all else remaining unchanged. This will clearly show financial institutions the magnitude of potential climate-related risks to come for better risk management activities. It would also be helpful if BNM could provide a narrative on acute risk that has severe impacts in the short to medium term for consideration.

Section 6: Financial Risk Coverage

Question 14: Do you agree with the Bank's proposal to quantify the climate impact on banks from a credit risk perspective only?

Yes, ASIFMA believes that amongst the classified risk types, credit, operational, market and liquidity, the greatest and most material impact would be on credit risk because of transition and even physical risk. As a result, the impact of climate risk on credit risk should be quantitatively assessed to identify the key drivers and account for the various scenarios. Assessments for market, liquidity and operational risk may be difficult as datasets may not be readily available, hence we agree with applying qualitative assessment for these risks.

Question 15: Does your institution currently have, or plan to have, resources and capability to quantitatively model the climate-related risks impact from credit, market, liquidity, and operational risks perspective over a 30-year horizon?

Currently, our bank members do not have or plan to have these resources and capabilities as there is a lack of guidance and expertise within this area. Once there is a supporting mechanism to develop the market-wide adoption of such risk assessments, the resource and capabilities will be developed in-house.

Question 16: Besides the risk channels listed above, are there other significant risk channels that are relevant for banks in Malaysia and should be considered by the Bank?

We would caution that while there are other risk transmission channels, banks and ITOs may not be equipped to assess them.

Section 7: Portfolio Exposure, Scope and Granularity

Question 20: Do you agree with the proposed scope and level of granularity?

We agree with the proposed scope and granularity as the breakdown of assessment by sector and by region (i.e., postcode) would sufficiently differentiate the respective risk exposures well enough, while having a reasonable but standardized measure of climate-related risk. However, the Industry notes that some aspects of the proposed scope, such as physical risk due to damages to vehicles from floods, may seem overly ambitious and could pose challenges. Any further increase to granularity would result in marginally diminishing levels of accuracy and complexity.

Question 21: What are the challenges (e.g., specific data gaps or modelling limitations) that would impede your ability to model the assessment at the proposed scope and level of granularity?

The first challenge we can expect to observe would be that there is a current lacking in terms of historical damages on a granular level because of physical risk such as floods, landslides, and typhoons. Next, there is no strictly regulated approach or a standardized approach in place for carbon or GHG emission disclosure within Malaysia. Aside from this, currently banks may not be assessing their data in the approach required and as such may need to invest in the necessary infrastructure to cater to this need. However, smaller banks with smaller portfolios may not be able to significantly benefit from the advantages of the above due to minimal financial exposure and impact. Aside from this, sectors in Malaysia have different maturity levels and goals in terms of managing climate risks. Smaller players may have even lesser information available comparing to the larger players. Due to this, a sectoral approach may lead to a mismatch of climate risk assessment findings. Aside from this, there is no standard approach currently being followed which can lead to a significant divergence in the results based on the respective assumptions inherent in the models. As a result, these model assumptions should be assessed and highlighted.

Question 22: Do you agree with the proposed scope for the counterparty-level assessment?

We agree with the proposed scope for a counterparty-level assessment. Counterparty level assessments are difficult at this juncture as there is a wide range of company maturity towards climate risk understanding. Nonetheless, they are necessary for better assessments. While data is available for listed entities, in the case of non-listed entities and SMEs, a top-down approach may be more suitable due to the data being unavailable.

Question 23: Beyond the sectors listed in Appendix 5, are there additional sectors that are crucial for banks to conduct the CRST exercise (e.g. due to materiality of banks' exposures to the sector or the sector's vulnerability to climate-related risks)?

ASIFMA and its members have no further comment.

Question 24: How would you reflect judgements about counterparties' current mitigation and adaptation plan in the quantitative assessment?

Banks should qualitatively assess the established strategy by material counterparties about transition, capital investments and mitigation and adaptation strategies. This assessment should rely on counterparties'

public declaration. However, we urge BNM to provide flexibility to the Industry in terms of the methodology of assessment and scope of clients that should be assessed.

Question 25: Do you foresee challenges in estimating the impact on the SME segment based on the sub-sectors provided?

We believe there would be significant challenges in estimating the impact on the SME segment due to limited data availability, particularly for the agriculture, forestry, and fishing industry, as well as a lack of understanding for the subject matter and thus failing to collaborate in a meaningful manner with the banks.

Question 26: Would your institution be able to assess the impact from the household segment based on the portfolio breakdown proposed?

The Industry notes that some aspects of the proposed scope, such as physical risk due to damages to vehicles from floods, may seem overly ambitious and could pose challenges. The Industry notes that there may be concerns on applying climate risk methodology to the existing internal scorecards for the segments under the scope of consideration for the 2024 CRST exercise.

Question 27: To model climate-related risks for the household sector, what kind of data specifications may be useful to be standardized across the industry?

As a start, it would be good to standardize the historical flood data and other climate events, annual change in income projections for individuals in the respective sectors or sub-sectors, collateral inventory and valuations for assets currently being used as collaterals for loans to allow for standardization across the industry. In addition, property price indices for different regions in Malaysia across different scenario and for the entire time horizon will also be useful. We would also like to request BNM to provide more guidance on how to assess physical risk impact for niche portfolios such as automobiles along with the relevant parameters.

Question 28: For DOMESTIC BANKING GROUPS (DBGs) with exposures to both overseas subsidiaries and branches, have you considered the climate-related risk impact on your overseas subsidiaries as well?

The impact on overseas subsidiaries have not been considered thus far.

Section 8: Balance Sheet Approach

Question 29: What could potentially be useful to complement the static balance sheet approach given its limitation?

We believe that banks should make a distinction between existing positions, maturing positions and new (i.e., repriced) positions in terms of both the average volumes of each of these three components and the Margin and Reference rate. Aside from this, the banks' interest income and expenses that evolve over the stress test time horizon due to the repricing of maturing assets/liabilities, the change in the margin and/or reference rate components earned/paid on assets/liabilities, and the migration of performing to non-performing positions will also be useful. Next, the bank should consider performing a separate independent assessment based on the changed or long-term strategy mix of the bank in terms of its portfolio

composition. By using a static balance sheet approach, the interest rate used should apply the current interest rate yield curve trend based on the market conditions at the time of stress testing.

Question 30: What are the possible challenges in reflecting and quantifying future management actions in the supplementary questionnaire?

We believe that there may be challenges that lie outside the bank's control such as quantifying and accounting for the wider market response towards the questionnaire and the inherent accuracy and applicability of the questionnaire to fit certain sectors and businesses, especially the SMEs. The process could be open to subjectivity and subject to changes as time passes.

Section 9: Submission Requirements

Question 31: Would the proposed key metrics accurately capture the climate-related risks faced by your institution?

We would encourage BNM to align with international practices and adopt the metrics used at previously completed climate risk stress testing exercises. This will allow international corporations with a presence in the Malaysian market to leverage on Group level frameworks and processes to fulfil the stress testing requirements and avoid duplication in supervisory exercises.

Question 32: Do you agree with the proposed breakdown/dimensions for the quantitative submissions?

We agree with the proposed breakdown and dimensions for the quantitative submissions as a start, especially given the existing maturity levels of market participants in relation to climate risk assessments. However, with time, we believe that a greater degree of robustness and applicability can be incorporated into the quantitative submissions to enhance it further.

Question 33: Are there other areas that you think the Bank should consider when preparing the qualitative questionnaire?

We believe there are other areas BNM should consider, such as, obtaining views from market participants in relation to how they intend to approach market, liquidity, operational, and other financial risks as they will be able to provide on-the-ground feedback in terms of the feasibility.

Section 11: Next Steps and Timeline

Question 34: Do you agree with the proposed broad timeline?

ASIFMA believes that a 2-year lead time for the 2024 CRST exercise would be challenging. Furthermore, as climate risk disclosure guidelines are expected to come into effect in 2024 (based on the current market progression), we urge BNM to consider the CRST exercise to occur during 2025 or after the first set of disclosures are reported, to allow for a more meaningful and accurate CRST exercise. This would allow Banks to apply less internal judgement on matters such as counterparty climate risks, resulting in a more standardised stress testing exercise across Banks. ASIFMA further urges BNM to outline future potential expectations of CRST to allow institutions to be better prepared for subsequent exercises.

Question 35: Based on the overall CRST proposals, how long do you think your institution would need to run the exercise?

We believe it could take exercise participants up to 6 months to run the initial exercise in 2024 given the limitations highlighted above. However, the duration is ultimately dependent on the complexity of a bank's business and operations, and thus can vary on a case-by-case basis. We would also like to highlight that the exercise duration and milestones are dependent on the data and the parameters that will be provided by BNM.

Question 36: Do you have suggestions on potential agencies or service providers that the Bank could collaborate with in relation to the localization of physical risk scenarios?

There are various potential agencies or service providers that BNM could collaborate with such as Carbon Care Asia, local climate-related departments such as the Meteorological Department, and other external rating service providers highlighted under Question 11.

Question 37: Data gap remains a key challenge. How do you think the industry can effectively work together to secure the essential data needs for the purpose of this exercise? Kindly refer to Appendix 4 on potential data gaps at this juncture that would require further effort by the industry. Please provide practical examples in the context of this exercise.

We believe robust and standardized data needs to be readily available in the market for banks and ITOs to provide meaningful information on their resiliency to physical and transition risks arising from climate scenarios. This can be done with close collaborations with other data providers and agencies listed above. Aside from this, a requirement of SME participation and incentivization scheme should also be defined clearly to obtain data points of clients that are not publicly available.