



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA



Value-based Intermediation Financing and Investment Impact Assessment Framework Guidance Document

The VBI Financing and Investment Impact Assessment Framework (VBIAF) has been prepared by Bank Negara Malaysia in collaboration with the VBI Community of Practitioners (CoP), the International Centre for Education in Islamic Finance (INCEIF) and The World Bank Group (Malaysia Office). The World Wide Fund for Nature (WWF) (Malaysia and Singapore Offices) also made significant contribution towards the drafting of this document, especially from the environment and social aspects.

Accompanying this document is a statement that summarises the feedback received during the consultation period and a clarification note on certain issues raised by the industry. Relevant feedback and suggestions received have been incorporated in this document. Any further queries and clarification is to be directed to vbi@bnm.gov.my.

DISCLAIMER

This document only serves as a guidance to the industry. Any views, findings, interpretations, conclusions or information provided in this document are a result of the collaboration between Bank Negara Malaysia and those identified above and hence, do not necessarily represent the official policy of Bank Negara Malaysia unless otherwise stated, nor does reference to or citing of trade names or commercial processes, constitute endorsement, recommendation or preference by Bank Negara Malaysia.

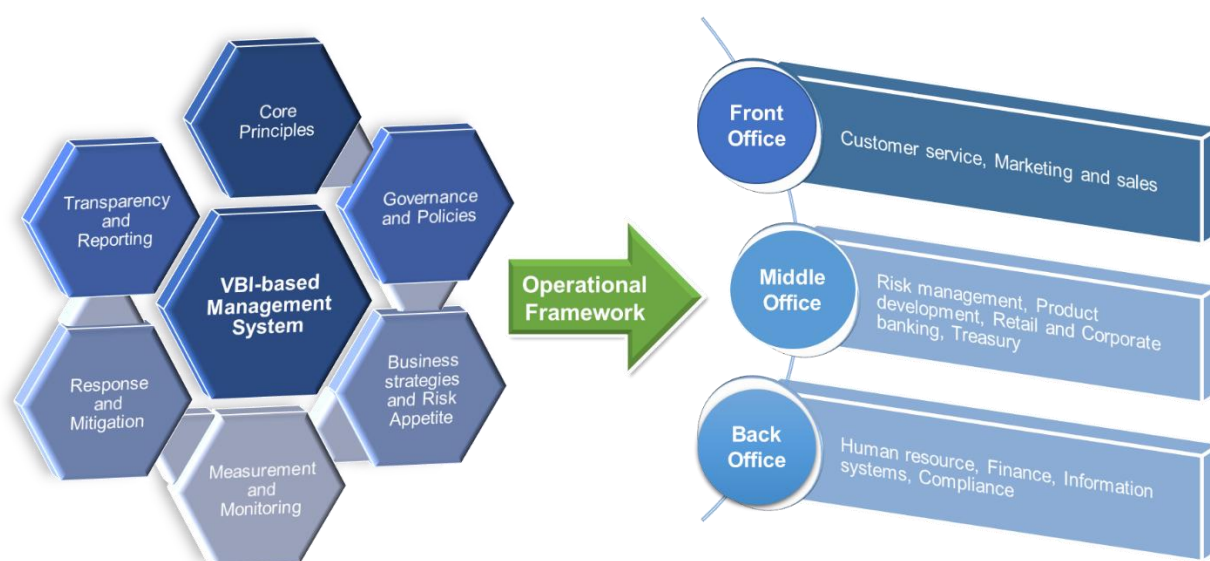
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Introduction

- The VBI commitment is premised on the underpinning thrusts described in the Strategy Paper and elaborated in the *Implementation Guide for VBI*. Although it is not a new concept, the key difference between VBI and initiatives such as Environmental, Social and Governance (ESG), Ethical Finance and Sustainable, Responsible Impact Financing (SRI) is the reliance on Shariah in the determination of its values, moral compass and priorities.
- The implementation of VBI will necessitate a comprehensive review of the existing business environment, essentially going beyond the current Shariah compliance culture and innovating new policies and systems that can further deliver the value proposition of Shariah.
- The implementation of VBI begins with the formation of the Corporate Value Intent (CVI), which articulates the Islamic financial institution's (IFI's) VBI commitment and forms the basis for the formulation of all policies and systems from the front office to the back office, including customer service, marketing, product development, risk management, treasury, compliance, finance, human resource and information technology.
- An IFI has to re-align the current risk assessment and management systems to the VBI commitment. A VBI-based management system sets out the overarching framework that defines the guiding principles and other requirements involved to operationalise the VBI strategy, identify, measure, monitor, mitigate and report risk exposures that may arise, on a dynamic and on-going basis. The establishment of an effective management system which commensurate with the nature and scale of the IFI's VBI implementation strategy has a direct impact on the success of its VBI commitment.

Diagram 1: VBI-based Management System is a guiding framework to IFI's operations



Objective

- This document outlines the framework to facilitate the establishment of an effective risk management system for financing and related advisory services and investment¹ activities that integrate the VBI consideration.

Approach

- This document is developed in reference to existing policy documents issued by the Bank, primarily *Risk Governance*, *Credit Risk and Guidelines on Investment Management for Takaful Operators*², and standards and guidance issued by international/multi stakeholder organisations and initiatives.
- The guidance comprises the following sections–
 - (i) Principles of VBIAF, which outline the overarching principles governing the development of an effective impact-based risk management system;
 - (ii) Principles of governance, which suggest considerations in enhancing governance process; and
 - (iii) Principles of impact-based risk management, which outline approach to integrate impact-based elements in existing credit risk² management system.
- The guidance contains–
 - (i) description of key ideas;
 - (ii) guidance on key principles that interprets the practical application of the key ideas; and
 - (iii) supporting examples of best practices adopted by financial institutions and practitioners.

Scope

- The scope of implementation of the VBIAF will depend largely on the respective technical, operational and financial VBI implementation strategy⁴ of individual IFIs, which may differ according to risk appetite, capacity and capabilities.
- In implementing the VBIAF, the IFI needs to consider the portfolio and customer perspectives. The IFI should assess the efficacy (both operationally and in the financial sense) of its implementation approach–

¹ The IFI as an asset owner and/or asset manager on behalf of its customers.

² At the time of publication, these refer to versions issued by the Bank on 1 March 2013, 27 September 2019 and 20 April 2019, respectively.

³ Impact-based risk considerations outlined in this document can also be applied to understand the impact of ESG factors on market and operational risks arising from an IFI's financing and investment activities. For example, information on ESG rating downgrade of listed corporations or more stringent environmental law imposed by the government on a particular industry can inform the IFI's measurement of equity risk under market risk. However, this document does not make any explicit guidance.

⁴ The adoption of VBI strategy is on a voluntary basis. This document serves as a guidance for those IFIs who have indicated a commitment to the VBI strategy. Reference is made to the implementation approach elaborated in the *Implementation Guide for VBI*.

- (i) from the portfolio perspective—
 - a phased/staggered approach, defined in this document as the initial application on a specific segment/portfolio of the IFI's financing and related advisory services and/or investment; or
 - a comprehensive approach, defined in this document as the application across all of the IFI's portfolios; and
- (ii) from the customer perspective—
 - a retrospective application, defined in this document as the application on all existing and new customers' financing/investment, which may be more holistic but could result in disruption of business⁵; or
 - a prospective application, defined in this document as the application on customers' new financing/investment only, which would be less disruptive but would eventually necessitate a review of those transactions contracted prior to the adoption of the VBI strategy to ensure the earlier businesses are aligned with the VBI commitment.

Depending on the IFI's risk appetite and VBI strategy, it is also possible to exclude certain types of customer or sectors.

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⁵ Disruption of business could arise from losses that may be incurred from having to amend or terminate the existing contractual obligations in order to achieve the VBI goals. In this instance, when considering its implementation strategy, the IFI must take into account the legal and financial risks of the existing contractual terms and conditions and weigh-in the appropriate cost and benefit of the proposed strategy.

Principles of VBIAF

Key ideas

1. The VBIAF should be built based on a set of guiding principles that articulates the operationalisation of the IFI's VBI commitment as described in its CVI. By first determining the guiding principles, the IFI will be able to address the implication of any changes in the way of doing business in a more systematic manner. From the set of guiding principles, specific policies and procedures are developed to effect the VBI strategy on the financing and investment decision-making process.
2. The set of guiding principles should be comprehensive and articulated in a sufficiently practical manner to facilitate effective implementation and observation of a tangible outcome.

Further guidance

The guiding principles established by the relevant institutions and practitioners (examples in paragraph 9) are broadly consistent with the Shariah proposition and the underpinning thrusts of the VBI. In particular, the following principles would be key to the design of the VBIAF:

(I) Attainment of benefit and prevention of harm

3. Under this principle, the IFI defines its approach to determine the positive (benefit) and negative (harm) impacts of any financing and investment activities. This includes determining its approach to measure materiality, define its priorities in conducting such activities (by sector and type of business or other) and the parameters that would govern the IFI's expectations on its counterparties (financing and investment customers, sukuk issuers etc.).
4. Any financing and investment activities undertaken by the IFI would be evaluated against this premise of benefit and harm. This premise is entrenched in the requirements of Islam and is reflected in the application of Shariah. The concept of "vicegerency" on the earth is well articulated in the Quran and the teachings of Islam, which has explicitly entrusted to humankind (the believers) the custodianship of all resources of the earth (water, food, land, energy, animals and etc.) and prescribed certain rights and rules regarding the social interactions between humans and their activities. This is very much in line with the concept of sustainability and triple bottom-line (people, planet and profit).
5. In this regard, the IFI would acknowledge that there is a profound interlinkage between the success and sustainability of its business and the natural and social capital, which it employs and affects. This perspective aligns with the growing expectations from shareholders and other stakeholders that value creation by the IFI should also contribute towards supporting and improving the resilience and sustainability of the society and environment more generally, in addition to that of the IFI itself.
6. Shariah emphasises that prevention of harm may take precedence over the attainment of benefit. When constrained with the choice between two harms,

Shariah informs that the lesser of the two must be chosen. Shariah also informs that the prevention of public harm should be given priority over individual harm.

7. Ideally, the IFI should aim to maximise benefit and minimise harm. However, it is acknowledged that the quantification of positive and negative impacts is not a precise science. In this instance, the IFI would need to apply its judgement⁶ based on all available data-driven evidence and consider the relevance of the impacts to the stakeholders when assessing materiality.
8. The IFI's decision-making in respect of the types and sectors of business that it ventures into would be guided by its CVI that encapsulates the priorities of the IFI. In developing its priorities and strategies, the IFI should first consider the national strategic interest/blueprint and local sustainable development goals^{7,8}. However, the IFI should also aspire to meet the goals and objectives set by well-established international standards that best express the ideas of sustainability. These include but not limited to–
 - (i) international agreements and conventions on sustainability – the 2015 Sustainable Development Goals (SDGs), the Paris Agreement, The New York Declaration on Forests, the Convention on Biological Biodiversity, the UNESCO World Heritage Convention, the UN Business and Human Rights Framework, and other relevant UN agreements;
 - (ii) best practice frameworks – Recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD), the Principles for Responsible Banking (PRB) and the Principles for Sustainable Insurance (PSI); and
 - (iii) international science-based multi-stakeholder standards – soft commodities certification standards, the Context-based Water Targets and the Science based Targets Initiative etc.

Examples of best practices



BNP Paribas is part of a multi-stakeholder group that helped to found and establish the Tropical Landscapes Finance Facility (TLFF). The TLFF leverages public funding to unlock private finance for sustainable land use, including in agriculture and ecosystem restoration, and for investments in renewable energy. As Sole Arranger and Lead Manager, BNP Paribas played a pivotal role in the landmark US\$ 95 million Sustainability Bond issued in February 2018. The transaction was ground-breaking as it was the first Sustainability Bond in ASEAN and in Asia to support a corporate. The projects financed through the Sustainability Bond consist of the responsible management of a rubber tree plantation, the conservation of a biodiversity area and provisions to improve the livelihood of local populations in rural regions of Indonesia, contributing to several of TLFF's core objectives. BNP Paribas sits on the Steering Committee that provides overall guidance on the activities of the TLFF.

Source: BNP Paribas website⁹ and TLFF website¹⁰

⁶ In particular where the financing or investment activities result in both positive and negative impacts.

⁷ This is consistent with the United Nation's document on "Transforming Our World: the 2030 Agenda for Sustainable Development", paragraph 55, page 13.

⁸ A summary of the main related policy/plan/programme in Malaysia is provided in Appendix: Resources and Tools.

⁹ https://cib.bnpparibas.com/sustain/finance-of-the-future_a-3-2097.html

¹⁰ <http://tlffindonesia.org/about-us/>



Yes Bank Commits USD 5 Billion for Solar Projects in India at International Solar Alliance (ISA)

Yes Bank, India's fifth largest private sector bank, made a major announcement to mobilise USD 1 billion until 2023 and USD 5 billion until 2030 towards financing the solar energy projects in India. This significant announcement is part of YES BANK's commitment to support ISA's vision of creating a robust eco-system for solar energy globally and the Government of India's target of achieving 100 GW of solar energy by 2022.

This development also comes on the back of recent USD 400 million co-finance agreement by YES Bank and European Investment Bank for construction of new solar power plants and wind farms across the country.

Source: YES Bank website¹¹



Islamic banks take part in financing green energy and empowering SME and entrepreneurship

The Islamic International Arab Bank (IIAB) signed an agreement with the Central Bank of Jordan in 2015 to develop Shariah compliant alternatives for mid-term financing based on Wakalah al-Istithmar for financing of energy efficient and renewable energy projects. Under this arrangement, the maximum amount of financing is US\$ 6 million and the maximum tenor is up to 120 months, with a fixed pricing based on the central bank's rediscount rate. In the effort of empowering SME and entrepreneurship, Al Baraka Turk emphasises product development that offers a range of financial solutions for different business sectors in the SME market. Several packages like the SME service package, dentist package and foreign commerce package have been offered by the bank to the market. This is mainly to empower small businesses and entrepreneurs, as well as to support SMEs to become part of the global value chain.

Source: CIBAFI Global Islamic Bankers' Survey 2016¹²



Swiss Re committed to being a responsible investor

Swiss Re has integrated ESG criteria for its investment portfolio based on three strategic pillars Enhancement, Inclusion and Exclusion. As part of the Inclusion pillar, Swiss Re targets investments that contribute to a low-carbon economy by investing in infrastructure renewables and green bonds. In 2018, 21% of its infrastructure investments were allocated to renewable energy, such as wind farms and solar panels and 23% were allocated to social infrastructure, such as hospitals, student dorms or affordable housing projects. Using the Green Bond Principles as guiding principles for its investments, Swiss Re has reached its 2018 green bond target of at least USD 1.5 billion by holding USD 1.6 billion at year-end.

Source: Swiss Re 2018 Corporate Responsibility Report¹³

¹¹ <https://www.yesbank.in/media/press-releases/yes-bank-commits-usd-5-billion-for-solar-projects-in-india-at-isa>

¹² <http://cibafi.org/ControlPanel/Documents/Library/Pdf/GIBSv2.pdf>

¹³ <https://reports.swissre.com/2018/>

(II) Integration of Shariah

9. Under this principle, the IFI defines its approach to integrate Shariah into its business strategy (i.e. VBI commitment) and operational design¹⁴.
10. The integration of Shariah must extend beyond a compliance approach to affect real change in behaviour and culture of the IFI towards embracing the VBI strategy.
11. The design of policies and procedures and capacity development should aim to enable a Shariah mind-set, which focuses on impact rather than a Shariah checklist, which focuses on exceptions.

Examples of best practices



United Nation's SDGs and Maqasid al-Shariah

The United Nations Development Programme (UNDP) and the Islamic Development Bank Group (IDBG) signed a Memorandum of Understanding (MoU) on collaboration between UNDP and IDBG to support the effective implementation and achievement of the SDGs. IDBG plans to increase its financial support to SDGs realisation to more than USD150 billion over the next 15 years.

The 2030 Agenda aspires to achieve the 17 high level SDGs and 169 specific targets, encompassing the social, economic and environmental dimensions of development. These aspirations for human dignity, and 'to leave no one behind', is fully in line with the principles and objectives of development from an Islamic perspective (*Maqasid Al-Shariah*).

For example, the IDBG launched a new fund, which will provide seed money to innovative start-ups and SMEs, helping them implement development projects related to the SDGs.

Source: Islamic Development Bank website¹⁵

Islamic Asset Management: Integrating ESG principles with Shariah-compliant investing

Responsible investment — an investing approach that incorporates ESG principles is making headway in the local Islamic asset management space. This gives investors who care about such issues another avenue when selecting funds.

In November 2016, BIMB Investment launched the first fund in the country that integrates Shariah and ESG principles in the investment decision-making process – the BIMB-Arabesque-i Global Dividend Fund 1. And this year, Nomura Islamic Asset Management established an in-house taskforce to

¹⁴ The Strategy Paper has provided a broad articulation of the intended outcomes of Shariah in financial transactions or the "*Maqasid al-Shariah*". *Maqasid al-Shariah* also incorporates the determination of priorities namely, *daruriyyat* (essentials), *hajjiyyat* (needs) and *tahsiniyyat* (embellishments) in the decision making process.

¹⁵ <https://www.isdb.org/what-we-do/sustainable-development-goals>

enhance and refine its ESG methodology in its research and investment process.

Responsible investment is welcomed by the Islamic asset management industry as it shares similar traits with Shariah investing, which also takes into account business sustainability and social responsibility. AIIAMAN and CIMB-Principal Islamic Asset Management (CPIAM) are two fund houses that have embraced the ESG trend, as they believe it will spur investor demand for Shariah-compliant funds.

Source: *The Edge Market*¹⁶

(III) Fairness and Transparency

12. Under this principle, the IFI defines its approach to ensure the appropriate transparency and disclosure, including (but not limited to) defining the users, types/content of information, the frequency and method of communication.
13. Transparent policies and procedures and effective disclosures are important measures to facilitate the necessary changes in doing business and demonstrate accountability to the VBI commitment and stakeholders.
14. Customers and investors should have adequate information about the changes in policies and procedures such as the eligibility criteria, information submission checklist, and monitoring and reporting requirements.
15. Appropriate and regular disclosures are necessary to communicate the progress and impact of the VBI strategy.
16. Local and international transparency and disclosure frameworks relevant to sustainability, such as those issued by Bursa Malaysia¹⁷, TCFD, Global Reporting Initiative (GRI), Sustainability Accounting Standard Board (SASB), should be considered when defining materiality and providing disclosure.

Examples of best practices



Bank Negara Indonesia (BNI) discloses its loan portfolio and progress towards achieving sustainability goal

BNI discloses detailed breakdown of loan portfolio by sector and size in its sustainability report. Besides providing a detailed report on credit exposure, BNI also reports the contribution of its loan portfolio to national development and Kredit Usaha Rakyat (KUR) (People's business credit) disbursement. The distribution of KUR reached 81.21% of the target set by the government in 2017 amounting to Rp12,000 billion. During 2017, BNI also distributed Rp57,646 billion in green financing for corporate segment or 30.66% of total

¹⁶ <http://www.theedgemarkets.com/article/islamic-asset-management-integrating-esg-principles-shariah-compliant-investing>

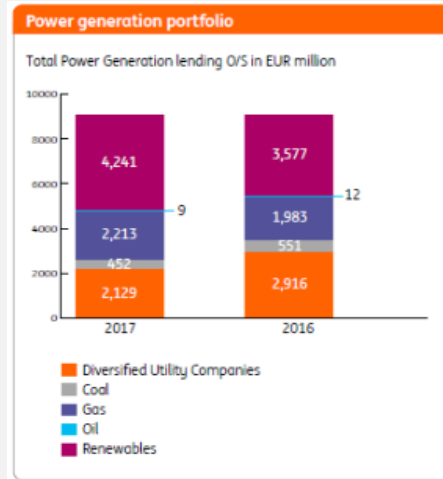
¹⁷ The "Sustainability Reporting Guide" and accompanying "Sustainability Toolkit: Governance", "Sustainability Toolkit: Materiality Assessment" and "Sustainability Toolkit: Materiality Matrix".

corporate loans, up from Rp21,570 billion in 2016 or 12.39% of total corporate loans and 7.54% of total BNI loans (excluding consumers).

Source: BNI Sustainability report 2017¹⁸



ING publishes insights into the environmental and social (E&S) risks of its portfolio and is transparent about its E&S criteria for risk management



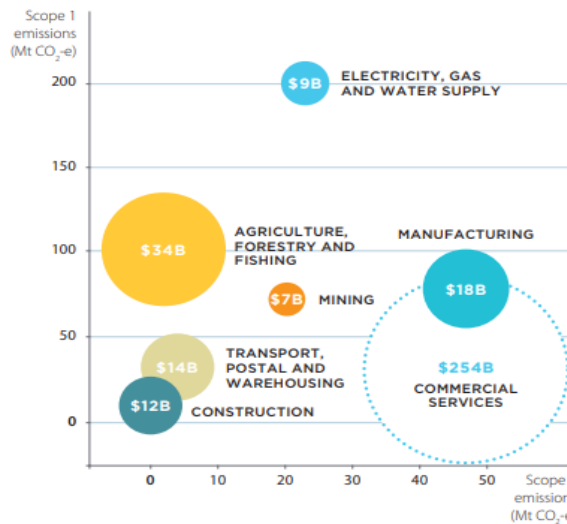
1. E&S framework and sector policies¹⁹
2. Energy portfolio breakdown²⁰
3. SDG reporting²¹

Source: ING Website²²



ANZ carbon footprinting of portfolio

BUSINESS LENDING AND TOTAL CARBON EMISSIONS OF KEY INDUSTRY SECTORS IN AUSTRALIA AND NEW ZEALAND



Source: ANZ website²³

¹⁸ http://www.bni.co.id/Portals/1/BNI/Perusahaan/Docs/BNI_SR2017_ENG.pdf

¹⁹ <https://www.ing.com/Sustainability/Sustainable-business/Environmental-and-social-risk-policies.htm>

²⁰ <https://www.ing.com/Sustainability/Our-Stance/Energy.htm>

²¹ <https://www.ing.com/Sustainability/The-world-around-us-1/Sustainable-development-goals.htm>

²² <https://www.ing.com/Sustainability.htm>

²³ http://shareholder.anz.com/sites/default/files/anz_2017_corporate_sustainability_review.pdf (page 66)

(IV) Constructive and inclusive collaboration with stakeholders

17. Under this principle, the IFI defines its approach to undertake effective engagement including (but not limited to) identifying the relevant stakeholders, determining the purpose, frequency and method of engagement and instituting feedback/response channel.
18. Active participation of stakeholders ensures that decision-making process under the VBIAF is conducted based on complete and transparent information. These could include engaging with–
 - (i) customers, investors and shareholders to understand and gauge their interest and appetite for sustainable products and services;
 - (ii) civil societies and local communities on an ongoing basis to obtain information about the actual and expected impact of the IFI’s financial products and services, and overall portfolio;
 - (iii) NGOs and technical experts to gain insights about emerging trends and understand credible science-based approaches (e.g. tools, standards) to mitigate risks; and
 - (iv) policy makers and regulators to understand regulatory expectations and support the transition to sustainable finance system.
19. The engagement process is critical in facilitating the stakeholder on-boarding process to create awareness and gain support for the IFI’s VBI commitment.

Examples of best practices



Kasikorn Bank (K-Bank) conducts on-going stakeholders’ engagement in doing business

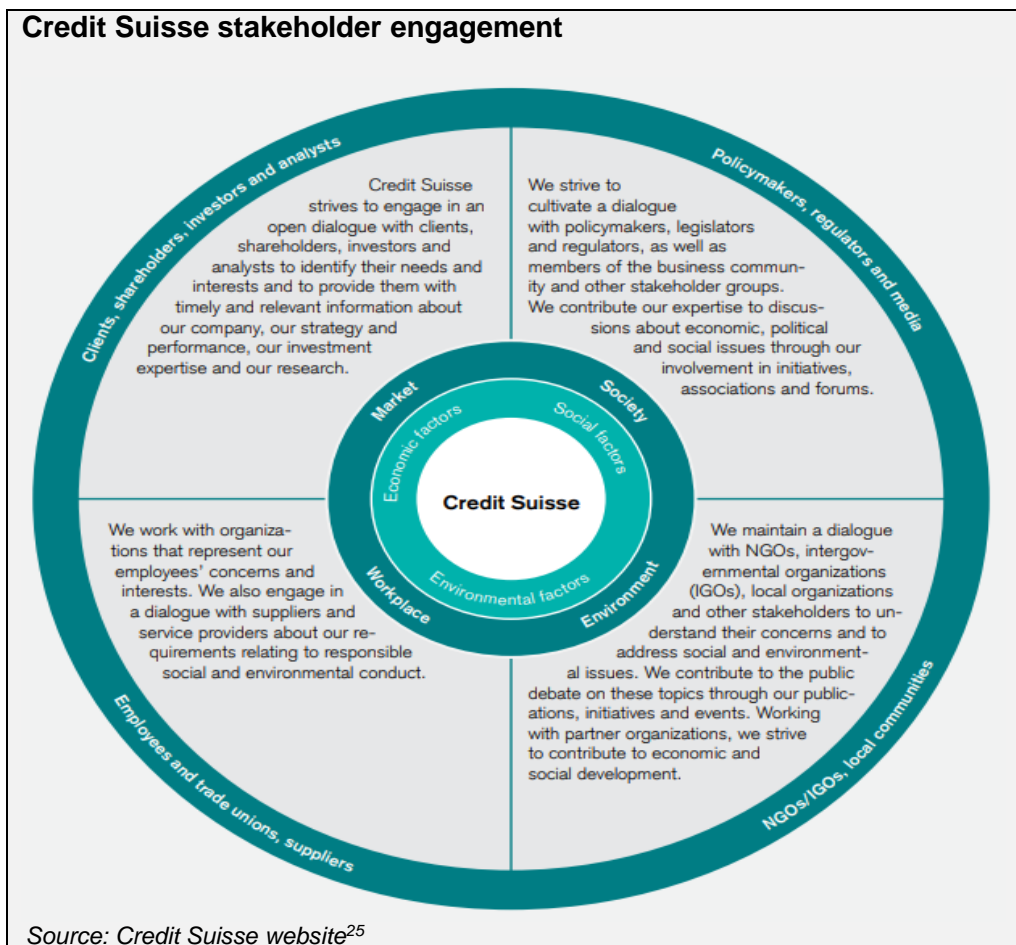
Stakeholder engagement is key to K-Bank’s ability to understand stakeholders’ requirements and expectations in order to map out effective operational guidelines to prevent risks or impacts that could occur due to improper performances. Stakeholders are classified into eight groups according to relevant business processes: shareholders, the Board of Directors, employees, customers, counterparties, competitors, creditors, communities, environment and society. K-Bank has adopted the AA 1000 Stakeholders Engagement Standard (AA 1000SES) and created stakeholder participation via related units and designed processes to identify their needs and concerns through various forms of activities such as meetings, seminars, customer and employee surveys and in-depth interviews. The results of these efforts have been used to determine practical guidelines that should alleviate negative impacts and efficiently generate added value.

Source: Kasikorn Bank Sustainability Report 2017²⁴

²⁴ https://www.kasikornbank.com/en/sustainable-development/SDAnnualReports/2017_SD_EN.pdf



Credit Suisse stakeholder engagement



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²⁵ <https://www.credit-suisse.com/media/assets/corporate/docs/about-us/investor-relations/financial-disclosures/financial-reports/csg-crr-2017-en.pdf> (page 11)

Principles of Governance

Key ideas

20. A robust and effective governance that is able to respond promptly to changes in the IFI's business strategies and operating environment whilst preserving the financial safety and soundness of the institution in the long-term is critical.
21. The VBIAF principles (see previous section) should be internalised throughout the institution to ensure that all decision-making processes are VBI-informed and reflected in the conduct of all activities²⁶.
22. Any enhancements to the IFI's governance structure^{27,28} should commensurate with the nature, size, complexity and risk profile of the IFI's VBI strategy and continue to be consistent with the requirements of existing standards issued by the Bank on *Corporate Governance*, *Risk Governance* and *Shariah Governance*.

Further guidance

The best governance practices would institute the following distinct features:

(I) Articulation of enhanced role of the Board

23. Establishing accountability at the highest level is essential to demonstrate the commitment to the VBI strategy in a manner that is consistent with establishing the "tone from the top". In line with the existing expectations²⁹, the roles and responsibilities of the Board in respect of oversight over the implementation of VBI strategy, including the implementation of a sound impact-based risk management system should be clearly articulated in its terms of reference.
24. The Board also needs to consider an effective strategy to build its capacity and expertise in the field of VBI, sustainability and impact-based assessments including participating in relevant initiatives/network such as the Sustainable Banking Network (SBN).
25. As part of its leadership role, the Board should also promote and support the institution-wide awareness and adoption of all aspects of the VBI strategy. This would require the Board and senior management to conduct a more regular

²⁶ This is consistent with the proposed Integrated Governance model described in the report "Integrated Governance – A New Model of Governance for Sustainability" published in June 2014 by the UNEP FI Asset Management Working Group Support. The report defines integrated governance as "the system by which companies are directed and controlled, in which sustainability issues are integrated in a way that ensures value creation for the company and beneficial results for all stakeholders in the long-term".

²⁷ For example, in determining the additional roles and responsibilities of the Risk Management Committee in respect of oversight over risk related to the VBI strategy and impact-based risk management, the IFI may refer to the proposals in the *Discussion paper on Responsibility Mapping* issued by the Bank in February 2018, subject to subsequent updates. The IFI also needs to consider its operational capacity when assessing the need to establish a separate VBI Oversight Committee.

²⁸ Reference is made to the journey towards integrating sustainability into Board strategy as presented in the "Sustainability Toolkit: Governance" issued in 2015 by Bursa Malaysia.

²⁹ At present, *Corporate Governance* has already stipulated the Board's role to promote sustainability through appropriate environmental, social and governance consideration in the IFI's business strategy. However, up to this period, it is acknowledged that the practical interpretation of this role has been very limited.

communication of the VBI strategy to internal and external stakeholders including speaking at public engagements.

Examples of best practices



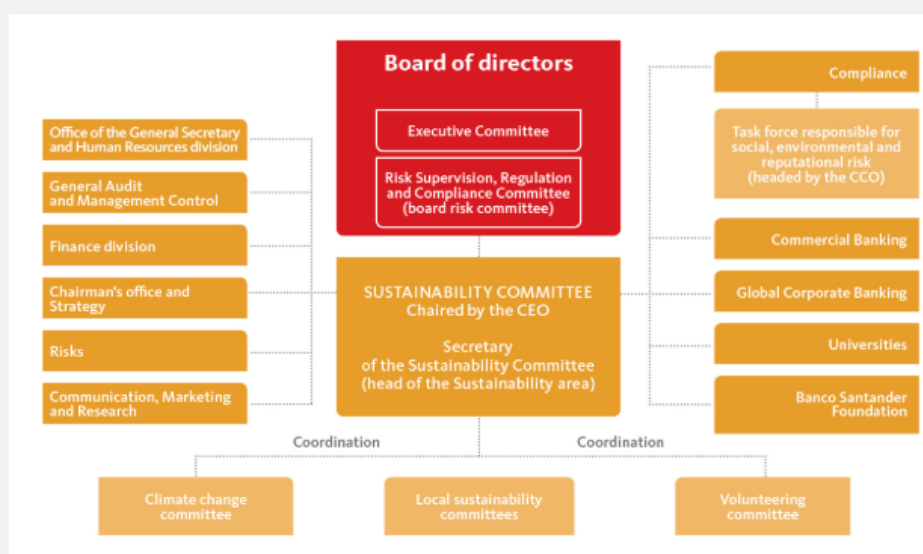
Articulation of enhanced role of the Board

ANZ's Board has the highest level of oversight and responsibility for climate change. Two board committees and an executive committee manage the risk: The Board Environment, Sustainability and Governance Committee (ESG Committee), which is responsible for reviewing and approving ANZ's climate change related objectives, including goals and targets; The Board Risk Committee, which has formal responsibility for the overview of ANZ's management of new and emerging risks, including climate change-related risks; and The executive Responsible Business Committee (RBC), which is chaired by the CEO and provides strategic leadership on our sustainability risks and opportunities, monitors progress against our targets, and has its minutes reviewed by the Board ESG Committee.

Source: ANZ website³⁰



Role of the board in sustainability framework of Santander Bank



Board's roles in relation to sustainability:

- Approves general policies and strategies relating to sustainability
- Oversees the corporate social responsibility policy
- Develops and implements group-wide sustainability strategy aiming at integrating E&S dimension of sustainability from a risk and opportunity perspectives into the bank's core business
- Promotes bank-wide cross divisional/functional collaboration on all dimensions of sustainability
- Decides that executive committee should be regularly briefed about the progress made on the bank's main sustainability initiatives

Source: Santander Bank Sustainability Report 2015³¹

³⁰ http://shareholder.anz.com/sites/default/files/anz_2017_tcf_disclosure_final.pdf

³¹ <https://www.santander.com>



DBS Board's Responsibility in Sustainability Governance

The Board has overall responsibility for sustainability and considers ESG matters in the formulation of their strategy. ESG matters that are material to value creation are integrated into balanced scorecard, which is used to set objectives, drive behaviours, measure performance and determine remuneration for their people. The scoreboard is updated yearly and approved by the Board. The Board delegates the execution of DBS strategy to the CEO, who heads the Group Executive Committee and is responsible for managing DBS' day-to-day operations.

The DBS Sustainability Council, chaired by the Chief Sustainability Officer and comprising senior leaders across business and support units, reports to the CEO. It is responsible for developing DBS overarching sustainability framework, setting key performance indicators (KPIs) and targets in consultation with the relevant stakeholders, and driving sustainability initiatives across the bank. The Council also advises the CEO on material ESG matters which contribute to DBS overall materiality assessment. This in turn informs the Board's strategic planning. The council meets monthly and provides periodic updates to the CEO, Group Management Committee and the Board.

Source: DBS website³²

(II) Integration of Shariah governance

26. The VBI strategy necessitates a more involved Shariah governance even at the development of the IFI's business and risk strategies. The Board needs to determine the roles and responsibilities of the Shariah governance functions in respect of the VBIAF.
27. The IFI needs to consider the most effective governance setup that ensures timely and appropriate information on Shariah perspective is obtained during the formulation of the business and risk strategies. Appropriate governance should also be in place prompt execution of policies and procedures, and rectification measures.
28. When implementing the VBIAF, the IFI may need to co-ordinate responses from credit risk, including impact-based criteria and Shariah perspectives for decision-making purposes³³. In this regard, to improve efficiency of the impact-based assessment process the IFI needs to consider a more streamlined set-up to minimise any potential errors and/or delays.

³² <https://www.dbs.com/sustainability/overview/sustainability-governance/default.page>

³³ For example, when assessing the priorities from a *Maqasid al-Shariah* perspective i.e. *daruriyyat* (essentials), *hajjiyyat* (needs) and *tahsiniyyat* (embellishments).

(III) Integration of VBI responsibilities across key functions³⁴

29. The integration of VBI responsibilities and strategies should be clearly articulated and cut across all relevant functions (including the IFI's three lines of defence i.e. risk management, compliance and audit) of the IFI's financing and investment activities such as credit/investment assessment, credit administration, credit/investment reporting.
30. To achieve this, the IFI may consider establishing a dedicated VBIAF implementation team initially or embedding selected and trained VBIAF leaders within each functions until the intended outcome of full integration is achieved—
 - (i) The VBIAF implementation team would serve as a control function and dedicated resource for the IFI to develop specific policies and procedures to address non-traditional credit risks arising from the VBI strategy, advise and facilitate adoption of VBIAF in other functions, and implement other VBI strategies. However, there must be adequate segregation of duties to mitigate conflict of interest and self-review issues.
 - (ii) The IFI could also select and provide targeted upskilling opportunities to its present resources or employ relevant experts to become VBIAF leaders who would facilitate implementation of the VBIAF. The VBIAF leaders would act as resource experts for the specific functions.

Examples of best practices

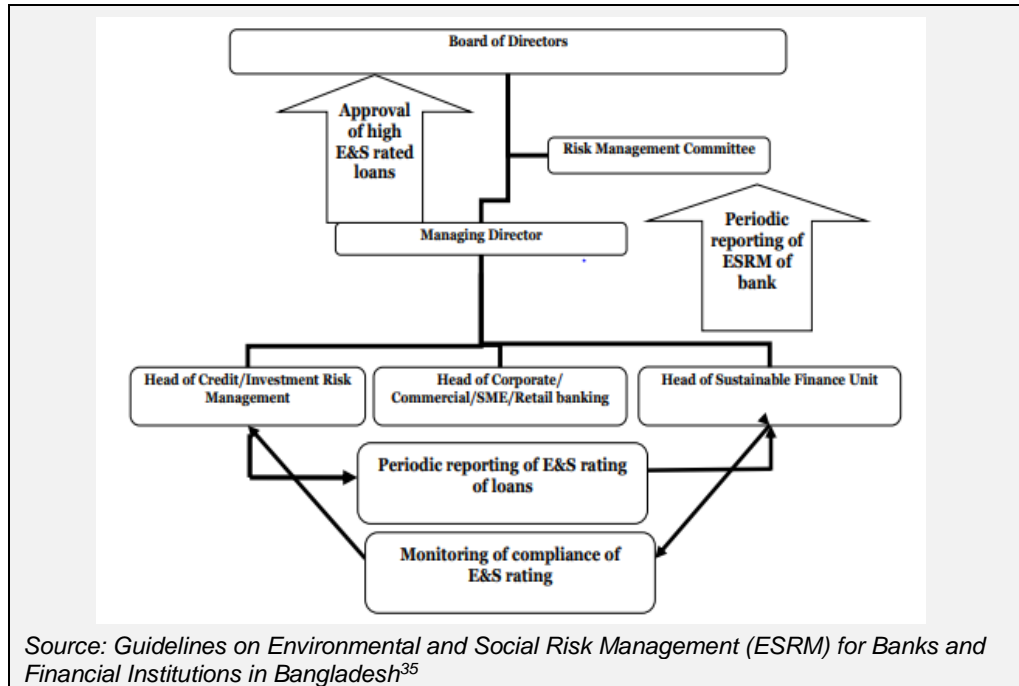


BANGLADESH BANK
Central Bank of Bangladesh

Integration of sustainability in the key functions of Bangladeshi banks

The Bangladesh Bank has issued a guideline, which requires banks to establish a Sustainable Finance Unit (SFU) that is responsible for the coordination with different departments and branches of the bank for ensuring the compliance of E&S risk management (ESRM) and proper implementation of E&S management systems (ESMS). The SFU is also responsible for updating the Board through the Sustainable Finance Committee on the status of the bank's portfolio regarding ESRM, facilitating the Board's decision-making process where there are unresolved E&S issues or non-compliance. The unit is also responsible for periodic reporting to the Bangladesh Bank and, as and when required.

³⁴ Integration is defined in this document as “the systematic and explicit inclusion of material impact-based risk factors into the IFI's analysis and decision making process”. This is consistent with the definition of ESG integration as defined by the UN Principles for Responsible Investment. Available online at <https://www.unpri.org/investor-tools/what-is-esg-integration/3052.article>



Sustainability at Deutsche Bank: Governance structure

Sustainability at Deutsche Bank Governance structure

Deutsche Bank Supervisory Board		Integrity Committee
Deutsche Bank Management Board Responsibilities for sustainability		Topics covered at Integrity Committee's meetings in 2016 included ...
John Cryan Chairman of the Management Board	Nicolas Moreau Head of Deutsche Asset Management	
Communications & CSR	Chief Investment Officer for Responsible Investments	
Group Sustainability	Deutsche Asset Management Sustainability Office	
Responsible for: — Development and implementation of Group-wide Sustainability strategy, aiming at integrating environmental and social dimensions of Sustainability from a risk and opportunities perspective into the bank's core business — Promoting bank-wide cross-divisional/functional collaboration on all dimensions of Sustainability — Target-group oriented transparency on Sustainability topics	Responsible for: — Provision and implementation of internal ESG governance framework — Development of internal ESG guidelines for Asset Management — ESG Governance within Asset Management RepRisk and NPA processes — Mandatory ESG reporting for Asset Management	— Governance — Culture — Environmental issues Examples: — Implementation of the bank's corporate culture within its organizational structures and the challenges related to this — Effects of the revised policies on coal mining and energy — Handling of issues related to the mountain top removal mining method — The bank's governance structures — Furthermore, it closely monitored high-risk litigation cases and regulatory proceedings and addressed the insights gained from this

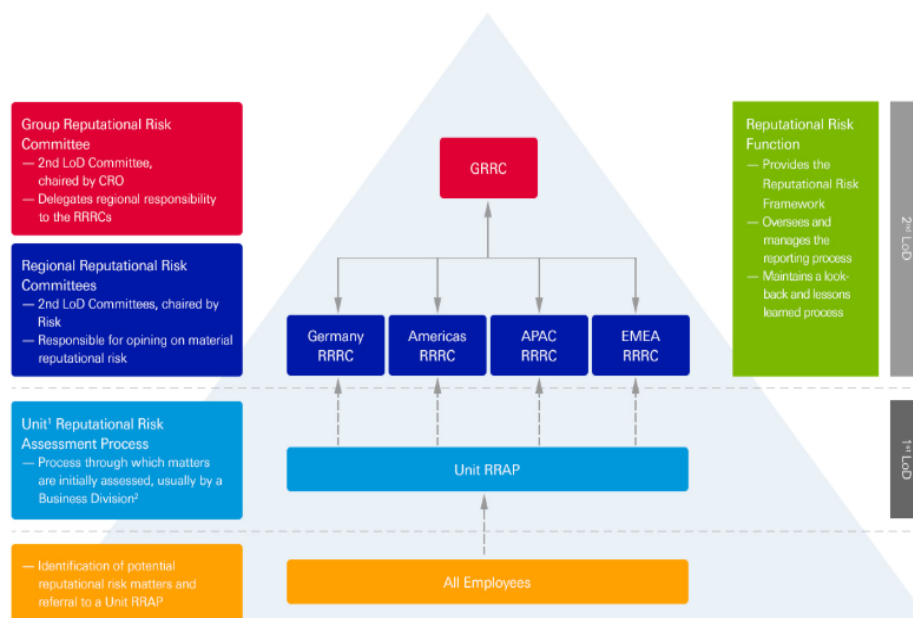
Deutsche Bank Investor Relations / Communications & CSR / Group Sustainability | Viktoriya Borysova / Dr. Antje Stobbe | 28 March 2017 | 4

³⁵ https://www.bb.org.bd/aboutus/regulationguideline/esrm_guideline_feb2017.pdf

Management of Reputational Risk Framework at Deutsche Bank

Deutsche Bank introduced a revised framework to manage reputational risk in 2015, which embodies the bank's 3 lines of defence principles. The framework is in place to manage the process through which active decisions are taken on matters which may pose a reputational risk, and in doing so, prevent any damage to Deutsche Bank's reputation wherever possible. The framework requires units to establish their own process through which reputational risk matters are initially assessed, ensuring accountability and ownership within the 1st line of defence. Matters may then be referred to the 2nd line of defence through one of four Regional Reputational Risk Committees which have been established (Germany, Americas, APAC and EMEA), as sub-committees of the Group Reputational Risk Committee, with responsibility for ensuring the oversight, governance and coordination of the management of reputational risk within their respective regions.

Deutsche Bank's Reputational Risk Framework



Source: Deutsche Bank's website³⁶

³⁶ https://www.db.com/cr/en/responsible-business/management-of-reputational-risks_.htm



Embedding sustainability in the insurance and investment businesses

Allianz integrates ESG by applying group-wide corporate rules and ESG processes across all its underwriting, investment, and asset management activities. In 2018, the third edition of the Allianz ESG Integration Framework was published to further increase transparency around its internal processes and guidelines related to its ESG approach.

ESG PROCESSES ACROSS ALLIANZ BUSINESS LINES

	Insurance	Investment	
		Listed	Non-Listed
ESG Referral Process	•		•
ESG Sensitive Business Guidelines ⁷	•		•
Sensitive Countries List	•		•
ESG Scoring Approach		•	
Engagement and Dialog ⁸	•	•	•
ESG Exclusion Policies	•	•	•
Asset Manager Mandating, Selection and Review		•	•

Source: Allianz 2018 Sustainability Report³⁷

(IV) Self-governance

31. As described in the VBI Strategy Paper, self-governance is defined as a culture of self-discipline, which is embedded within the operations and practices of the IFIs. This would result in greater accountability and integrity motivated by doing what is good and right, and not merely motivated by regulatory compliance³⁸.

Examples of best practices



The core of DBSs people strategy

At DBS, employees are expected to reflect PRIDE in their work and live these values — Purpose-driven (Create impact beyond banking), Relationship-led (Collaborate to win for DBS), Innovative (Embrace change), Decisive (Think. Act. Own.), and E! (Everything fun!). The bank has made conscious efforts to rally ahead of other banking institutions, wherein it aims to build a digitally savvy workforce via development opportunities for employees. DBS Asia Hub 2 (DAH2), which was set up in 2016, is enabling the bank to drive innovation, further technological capabilities across the region and support its digital banking strategy in key markets.

Source: DBS website³⁹

³⁷ <https://www.allianz.com/en/sustainability/publications-news/publications.html>

³⁸ Further articulation is provided in the *Implementation Guide for VBI*.

³⁹ <https://www.dbs.com/about-us/our-values/default.page>



Bank Austria builds the “Bank of the Future” with feedback software

Communities represent a major trend. Since the beginning of 2013, Bank Austria created two large-scale online communities, providing its customers and employees with the chance to shape the bank’s future. Launched with the slogan “Bank mitdenken, Bank mitlenken” (“Let’s shape our bank together”) they provide a platform for customers and employees to contribute their opinions and ideas through discussions, surveys and quick polls on topics ranging from the bank of the future, to contactless payment and mobile banking applications.

Both communities have increased engagement and provided effective insight that has helped drive change. In just over two years, a total of around 7,000 customers and employees are active in the two Bank Austria communities. Eight feedback modules have produced over 600 articles and over 16,000 completed feedback surveys, leading to constant interaction between the bank and its customers and employees. These discussions, expert blogs and real-time surveys complement Bank Austria’s traditional market research methods. Opinions and ideas collected through the communities are having a major impact on the business, as feedback results from both forums are integrated into management decisions and influence the further development of Bank Austria’s strategy. The communications process within the communities are not a one-way street: To ensure continual engagement, customers and employees receive exclusive updates that shows how their feedback has led to changes in the bank’s operations.

Source: Case study Bank Austria by Quebec⁴⁰

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⁴⁰ <https://www.questback.com/assets/usa/case-studies/CaseStudy-BankAustria-Questback-EN-USA.pdf>

Principles of Impact-based Risk management⁴¹

Key ideas

32. The VBIAF expands the existing credit risk management practices (base approach) to include an impact-based dimension in managing risks under the VBI strategy. Traditionally, credit risk (including counterparty credit risk) encompasses the risk of a counterparty failing to perform its obligations in accordance with agreed terms⁴². An impact-based approach considers the implication of the financing and investment activities funded by the IFI on the stakeholders based on the principles and strategies established in accordance with its CVI and the broader goal of a sustainable and resilient future. To the extent possible, the risks identified under the impact-based approach should be appropriately quantifiable to facilitate effective measurement and monitoring of such risks.

Case example: Investment in highway construction project

An IFI is considering investing in a *sukuk* programme for the construction of a new highway that will connect a new township with the city centre. Traditionally, the IFI would evaluate the decision to invest in the *sukuk* based on certain quantitative (e.g. net present value computations, profit rate sensitivity, *sukuk* rating, liquidity etc.) and qualitative (e.g. management strength, legal risks, etc.) factors.

Under the impact-based approach, the IFI needs to also review the positive and negative impacts that will be generated from the project. In Malaysia, highway construction is categorised as prescribed activities under the Environmental Quality (prescribed activities) (Environmental Impact Assessment) Order 2015. The IFI can use the Environmental Impact Assessment (EIA) report to ascertain the impact risk related to the project and the mitigation measures that have been identified by the *sukuk* issuer. The IFI can also make use of relevant ratings such as Sustainable INFRASTAR issued by the Construction Industry Development Board Malaysia (CIDB) to assess the impact of the project. In addition, the IFI should also evaluate the project against its own impact criteria that are not addressed either in the EIA report or rating methodology.

The IFI can use this information to engage with the *sukuk* issuer to raise any concerns about negative impact and suggest mitigation measures including incorporating additional covenants in the *sukuk* agreement.

Case example: Financing expansion of a chemical plant

An existing customer is requesting a new project financing from an IFI to expand its existing chemical plant to keep up with increasing demands of its products. At present, the IFI would typically evaluate the financing request based on

⁴¹ Examples of best practices for this section are compiled in Appendix – Resources and Tools.

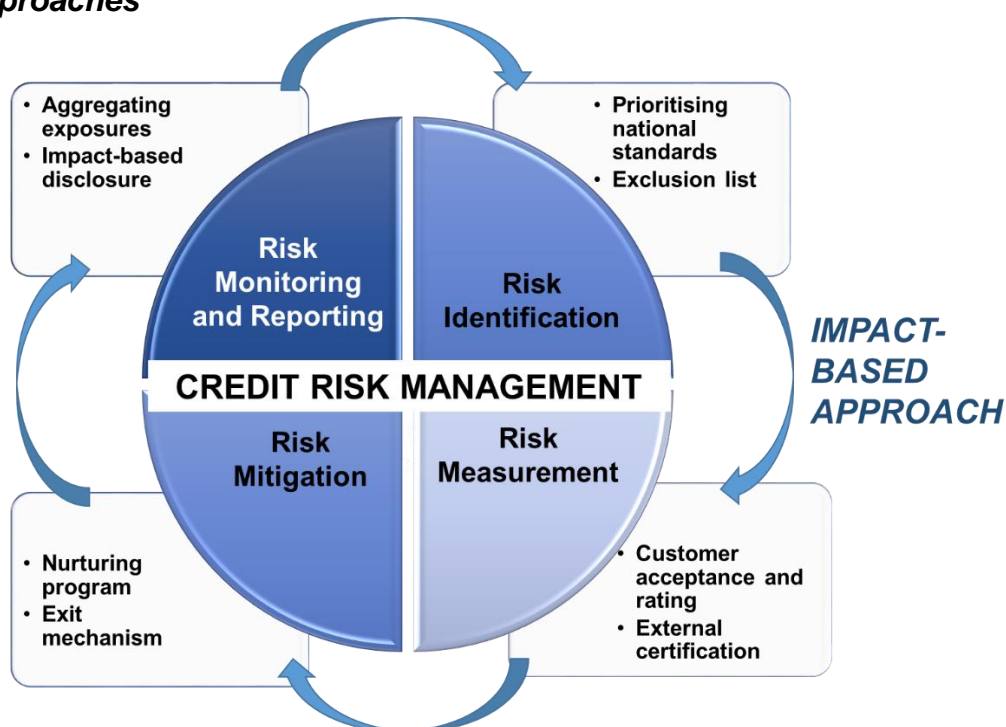
⁴² Typically financial obligations or terms, which have financial effect e.g. collateral execution.

traditional credit criteria i.e. customer’s repayment capability. Under the impact-based approach, the IFI needs to conduct a customer impact on-boarding assessment to determine the positive and negative impacts that is likely to be generated from the project. Depending on the size of the expansion project, the customer may be required to conduct an EIA that the IFI can rely on. If not, the IFI needs to conduct its own assessment. In addition, the IFI may seek feedback from other stakeholders such as community leaders (if the plant is near to residential areas) and environmental groups to get more information about the project and feedback about the impact of the customer’s activities.

Similarly, the IFI can use this information to engage with the customer to raise any concerns about negative impact and suggest mitigation measures including incorporating additional covenants in the financing agreement.

33. The *Credit Risk and Guidelines on Investment Management for Takaful Operators* policies issued by the Bank are reference points to develop the VBIAF. In this regard, the guidance described in this document is expected to supplement the IFI’s existing credit risk and investment management practices.

Diagram 2: Linking credit risk and impact-based risk management approaches



34. In general, comprehensive credit risk management entails a sound understanding of the inter-linkages between credit risk and other risks⁴³. The guidance provided in this document aims to highlight the non-traditional inter-linkages⁴⁴ that would

⁴³ This would include consideration of the legal and regulatory environment and government policies that may impair the counterparties’ ability to fulfil their credit obligation to the IFIs.

⁴⁴ Traditionally an IFI would only consider a limited number of factors when assessing a customer’s credit risk such as considering the market risk impact of the customer’s collateral value or impact of government legislation

need to be considered under the impact-based approach. Increasingly, such non-traditional inter-linkages could result in financial impact, and failing to account for them can lead to mispriced credit risk⁴⁵ that can impair the IFI's safety and soundness and consequently weaken financial stability.

Diagram 3: Transmission channels of physical risk to financial stability⁴⁶

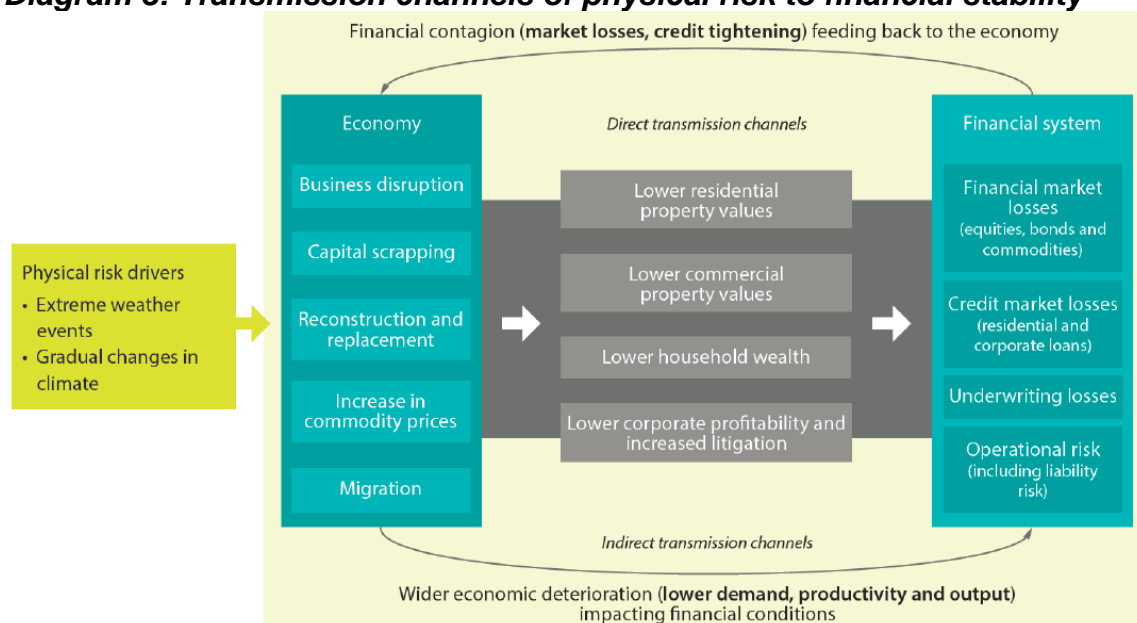
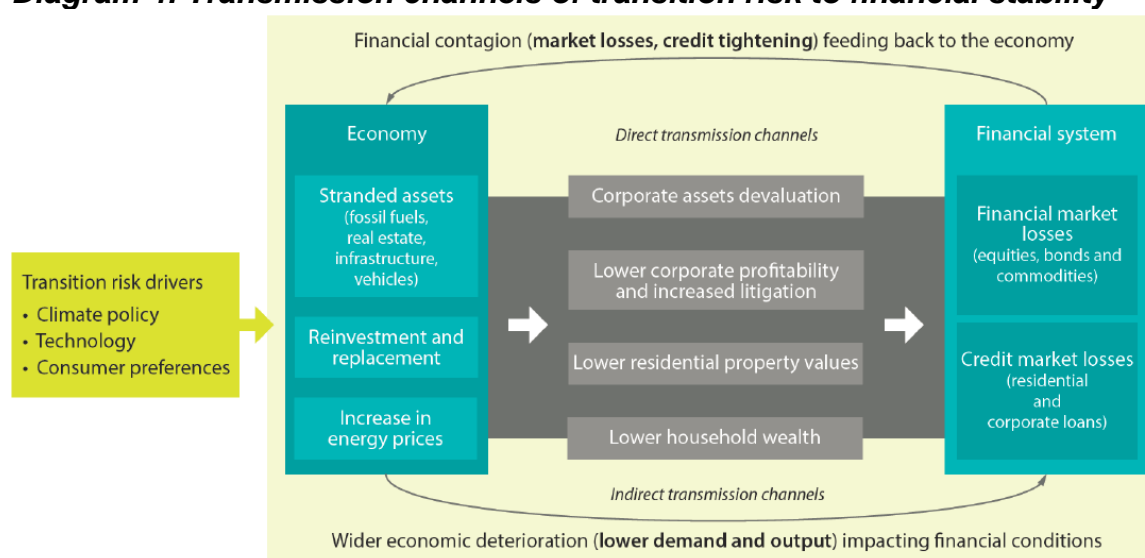


Diagram 4: Transmission channels of transition risk to financial stability⁴⁷



on the customer's business. However, non-traditional inter-linkages through E&S impacts are increasingly becoming more important and can have a direct impact on customer credit standing. For example, a customer exposed to severe legal implications because of improper hazardous waste management and poor occupational health and safety measures will not only encounter negative financial impact but also significantly damage its reputation.

⁴⁵ For example, E&S risk considerations can have an impact on the customer's collateral value e.g. land, factory building. An IFI may overvalue the collateral if it does not consider any additional land rehabilitation cost imposed by relevant authorities.

⁴⁶ Network for Greening the Financial System (NGFS) First comprehensive report, April 2019.

⁴⁷ Ibid.

35. The impact-based assessments should be developed based on the following principles–
- (i) effective participation from relevant stakeholders⁴⁸
Impact-based approach requires input from various internal and external stakeholders such as management, risk specialists, relevant regulators/authorities and other external stakeholders, including civil society (NGOs) and local communities. The IFI needs to identify the relevant stakeholders at the various processes to ensure the framework is robust and incorporates significant input that would influence the achievement of its VBI strategies.
 - (ii) engage and nurture counterparties towards common goals
On-boarding procedure is a critical feature of the VBIAF to facilitate support/buy-in from the counterparties (financing and investment customers, sukuk issuers etc) and other stakeholders for common goals and sustainability of the VBI strategy.
 - (iii) foster data-driven approach and use of technology
The decision-making process would need to be supported by appropriate and credible data-driven evidence. For this purpose, the IFI should use available and credible data providers and technology (e.g. artificial intelligence and big data) to effectively manage the amount of quantitative and qualitative information that is involved in implementing the VBIAF⁴⁹.
 - (iv) integration between existing risk assessment and management systems
Efficient integration into existing infrastructure ensures implementation of the VBIAF is cost-effective and seamless. The IFI would need to consider taking a measured approach towards integrating the new design of risk management into current infrastructures e.g. adopting non-automatic tools for non-critical procedures and processes until automation can be completed.

Further guidance

(I) Impact-based risk identification

36. The IFI needs to establish a comprehensive approach to identify and categorise impacts, both positive and negative to the value of the IFI's financing and/or investment assets. This can be done through direct exposure or through feedback processes in the broader economy and society, whether in the short or in the long-term⁵⁰. This process would allow the IFI to identify negative impacts that will require mitigation or further action by the IFI and/or customers. This will also enable the IFI to determine the most appropriate risk management tools and engagement groups and channels.

⁴⁸ Reference is made to the "Sustainability Toolkit: Stakeholder Prioritisation" issued in 2015 by Bursa Malaysia.

⁴⁹ In accordance with *Guidelines on Data Management and MIS Framework* issued by the Bank.

⁵⁰ Identification of positive and negative impacts are critical input in measuring the impact to the IFI's triple bottom-line (TBL).

37. The customers' businesses, if not run properly, can be a source of negative impact such as climate risk, biodiversity loss and deforestation, labour and human rights abuse, pollution, corruption etc. either directly or through their supply chain. If not managed well, the issues presented above can contribute to the degradation and depletion of natural and social capital, which presents a significant threat to the long-term resilience and growth of businesses and wider economy and society⁵¹ with ramifications on financial institutions.
38. The IFI should develop tools and methodologies to understand if a customer in a particular industry is at risk of causing negative impacts⁵². Examples of tools for identifying material negative impacts at the sector and subsector level are listed below⁵³–
- (i) The Environmental Quality (Prescribed Activities) (Environmental Impact Assessment) Order 2015 specifies a list of activities requiring an environmental impact assessment (EIA) to be conducted.
 - (ii) The SASB Materiality Map is an interactive tool that can be used to identify common sets of E&S issues across industries and sectors⁵⁴.
 - (iii) The Centre for Disease Control and Prevention (CDC) Sector Profiles draw on internationally recognised good practice standards and guidance, particularly the International Finance Corporation (IFC) Performance Standards and the World Bank Group Environmental, Health and Safety (EHS) Guidelines⁵⁵.
 - (iv) The TCFD framework can be used by the IFI and its customers to better understand material climate-related risks and opportunities. The framework also defines concepts of physical and transition risk that can also be applied to other E&S issues.
 - (v) PSI's "Underwriting environmental, social and governance risks in non-life insurance business" document includes an "ESG risks and economic sectors heat map" which is a guidance tool to get an indication of levels of potential ESG risks across economic sectors⁵⁶.
 - (vi) Exploring Natural Capital Opportunities, Risks and Exposure (ENCORE) is a tool that helps financial institutions to better understand, assess and integrate natural capital risks in their activities⁵⁷.

⁵¹ <https://www.fsb-tcf.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf>

⁵² For the purpose of identifying and categorising the impacts, the IFI should consider 'real' and not 'perceived' impact risk i.e. taking into consideration the likelihood and significance of the impact risk. Hence, to effectively validate the impact risk, the IFI would require robust information source and data management system.

⁵³ The IFI may also utilise local regulation and standards such as that produced by the SIRIM QAS International Sdn. Bhd. and Department of Environment of Malaysia (DOE). (Refer to section on Prioritising national interest and local regulations and standards)

⁵⁴ <https://materiality.sasb.org>

⁵⁵ <http://toolkit.cdcgroup.com/>

⁵⁶ <https://www.unepfi.org/psi/underwriting-esg-risks/>

⁵⁷ <https://encore.naturalcapital.finance/en/>

Table 1: Example of ESG impact to be considered in selected sectors⁵⁸

Sector	List of most relevant ESG issues
Agriculture and fishery	<ul style="list-style-type: none"> • Greenhouse gas (GHG) emissions • Uncontrolled fishing • Illegal, unregulated, unreported fishing • Impact on marine protected areas and other marine biodiversity loss • Water use and wastewater management • Biodiversity loss and deforestation • Unsafe/prohibited pesticide/herbicide • Human rights and community relations • Labour practices, occupational health and safety (OHS) • Supply chain management
Forestry	<ul style="list-style-type: none"> • GHG emissions • Water use and wastewater management • Biodiversity loss and deforestation • Unsafe/prohibited pesticide/herbicide • Human rights and community relations • Labour practices, OHS • Supply chain management • Illegal logging
Beverages/ food manufacturers	<ul style="list-style-type: none"> • Sustainable raw materials • Water use and wastewater management • Packaging • GHG emissions/energy management • Labour practices, OHS • Supply chain management
Mining, metals, chemicals	<ul style="list-style-type: none"> • GHG emissions/energy management • Biodiversity loss and deforestation • Water use and wastewater management • Chemical security • Waste and hazardous materials management • Human rights and community relations • Labour practices, OHS • Accident and safety management • Site decommissioning and remediation
Energy	<ul style="list-style-type: none"> • GHG emissions • Water use • Air and water pollution • Impact on biodiversity • Human rights and community relations • Labour practices, OHS
Infrastructure	<ul style="list-style-type: none"> • Biodiversity loss and deforestation • Water use • Pollution • Community relations • Labour practices, OHS

⁵⁸ The list is not exhaustive. For further reference, see International Finance Corporation (IFC) Performance Standards and the World Bank Group Environmental, Health and Safety (EHS) Guidelines.

Table 2: TCFD Framework on climate-related risks

Type	Climate-Related Risks ³²	Potential Financial Impacts
Transition Risks	Policy and Legal	
	<ul style="list-style-type: none"> – Increased pricing of GHG emissions – Enhanced emissions-reporting obligations – Mandates on and regulation of existing products and services – Exposure to litigation 	<ul style="list-style-type: none"> – Increased operating costs (e.g., higher compliance costs, increased insurance premiums) – Write-offs, asset impairment, and early retirement of existing assets due to policy changes – Increased costs and/or reduced demand for products and services resulting from fines and judgments
	Technology	
	<ul style="list-style-type: none"> – Substitution of existing products and services with lower emissions options – Unsuccessful investment in new technologies – Costs to transition to lower emissions technology 	<ul style="list-style-type: none"> – Write-offs and early retirement of existing assets – Reduced demand for products and services – Research and development (R&D) expenditures in new and alternative technologies – Capital investments in technology development – Costs to adopt/deploy new practices and processes
	Market	
<ul style="list-style-type: none"> – Changing customer behavior – Uncertainty in market signals – Increased cost of raw materials 	<ul style="list-style-type: none"> – Reduced demand for goods and services due to shift in consumer preferences – Increased production costs due to changing input prices (e.g., energy, water) and output requirements (e.g., waste treatment) – Abrupt and unexpected shifts in energy costs – Change in revenue mix and sources, resulting in decreased revenues – Re-pricing of assets (e.g., fossil fuel reserves, land valuations, securities valuations) 	
Physical Risks	Reputation	
	<ul style="list-style-type: none"> – Shifts in consumer preferences – Stigmatization of sector – Increased stakeholder concern or negative stakeholder feedback 	<ul style="list-style-type: none"> – Reduced revenue from decreased demand for goods/services – Reduced revenue from decreased production capacity (e.g., delayed planning approvals, supply chain interruptions) – Reduced revenue from negative impacts on workforce management and planning (e.g., employee attraction and retention) – Reduction in capital availability
	Acute	
	<ul style="list-style-type: none"> – Increased severity of extreme weather events such as cyclones and floods 	<ul style="list-style-type: none"> – Reduced revenue from decreased production capacity (e.g., transport difficulties, supply chain interruptions) – Reduced revenue and higher costs from negative impacts on workforce (e.g., health, safety, absenteeism) – Write-offs and early retirement of existing assets (e.g., damage to property and assets in “high-risk” locations)
	Chronic	
<ul style="list-style-type: none"> – Changes in precipitation patterns and extreme variability in weather patterns – Rising mean temperatures – Rising sea levels 	<ul style="list-style-type: none"> – Increased operating costs (e.g., inadequate water supply for hydroelectric plants or to cool nuclear and fossil fuel plants) – Increased capital costs (e.g., damage to facilities) – Reduced revenues from lower sales/output – Increased insurance premiums and potential for reduced availability of insurance on assets in “high-risk” locations 	

39. The IFI could address the above-mentioned issues through sector and issue-specific policies. Such policies should clearly state the requirements for customers’ performance and should ensure that such requirements are effective and sufficient to manage its impact-based risks. Such performance requirements should be in line with national policies/agenda (refer to section on Prioritising national interest and local regulations and standards) including where possible referencing international standards, best practice frameworks and robust multi stakeholder

certification systems (refer to section on Leveraging on external certification and verification).

40. As part of the customer on-boarding process, the IFI may apply the following methods to identify the gaps in customer's performance against the IFI's own policies–
- (i) desktop analysis of customer's public disclosures (e.g. dedicated sustainability website, sustainability policies, annual report, sustainability report);
 - (ii) interview with the customer;
 - (iii) use of external databases e.g. Carbon Disclosure Project (CDP);
 - (iv) analysis with use of geospatial tools e.g. World Resources Institute's (WRI) Global Forest Watch (GFW); and/or
 - (v) independent third-party assessment e.g. High Conservation Value (HCV) Licensed Assessors for cases where alternatives do not provide sufficient level of due diligence.

Table 3: Examples of questions for the interview with customers

<p>Governance</p> <ul style="list-style-type: none"> • Describe the Board's oversight of E&S and climate-related risks and opportunities. • Describe management's role in assessing and managing E&S and climate-related risks and opportunities. • Please outline your internal ESG framework (group/subsidiary level) • Is there a dedicated unit responsible for sustainability, sustainable finance, etc.? • How many people within the organisation dedicate (part of) their work time to sustainability topics/initiatives? <p>Strategy</p> <ul style="list-style-type: none"> • Is sustainability part of your strategy and what are your key sustainability priorities over the next 1, 3 and 5 years? • How does your organisation identify and assess materiality of sustainability topics/issues? • Who are the stakeholders you engaged with on E&S issues and how do you implement stakeholder management? • Which E&S risks and opportunities have the organisation identified over the short, medium, and long-term? • What is the impact of E&S risks and opportunities on the organisation's businesses, strategy and financial planning? <p>Risk management</p> <ul style="list-style-type: none"> • Please outline your ESG policy framework (group/subsidiary level) and related procedures? • Are your policies aligned with national, international agreements and conventions on sustainability, best practice frameworks and robust international science based multi-stakeholder standards? • Do you maintain or generally align with any internationally recognised management systems, e.g. MS ISO 14001:2015, MS 1722:2011, OHSAS 18001? • Are you currently undergoing any industry certification or external verification (e.g. commodities certifications)? • Do you understand and assess your E&S supply chain risks and how do you manage those risks?
--

- Are there any areas where you need external support on E&S management, either from the financier/bank or a technical consultant?
- Metrics and Targets**
- Which metrics do you use to assess your E&S risk exposure?
 - Do you assess your Scope 1, Scope 2, and Scope 3 greenhouse gas (GHG) emissions and the related risks?
 - What are your key objectives and KPIs for implementing E&S policies and are those being regularly reported to the Board?
 - Do you target to align your performance with scientific scenarios (e.g. a 2°C climate warming scenario) and international agreements for sustainability (e.g. the SDG)?

Table 4: Examples of external databases/ automated tools

Tools	Sector	Issues covered	Type
Sustainability Policy Transparency Toolkit (SPOTT)	Palm Oil, Timber, Pulp and Pape	Most common issues in the sector	Public disclosure
CDP	Various	Climate, Deforestation, Water	Public disclosure / survey data
Water Risk Filter	Various	Water	Geospatial
Soft Commodity Risk Platform (SCRIPT)	Palm Oil	Deforestation and human rights	Public Disclosure
WRI	Various	Deforestation, Water	Geospatial

Prioritising national interest and local regulations and standards

41. The IFI needs to identify relevant national E&S standard, which includes consideration towards national strategic interest/blueprint. If relevant local regulations and standards are unavailable, the IFI should develop a comprehensive impact identification method in consultation with relevant stakeholders.
42. However, aligning with international agreements and conventions, best practice frameworks and robust international science-based multi stakeholder standards ensures that the IFI would also strive to globally accepted standards. This would promote its global competitiveness.
43. In this regard, national standards should be considered in combination with international standards, where applicable. Where the policy intention is to align the national standard with the international equivalent, the IFI could play a proactive role in collaborating with local stakeholders and developing an action plan to facilitate alignment within a reasonable time.

Table 5: Key national and international standards⁵⁹

Issue	National and international standards
Climate	National Policy on Climate Change*, The Paris Agreement, TCFD of the Financial Stability Board (FSB), Science Based Target Initiative
Biodiversity and Deforestation	National Policy on Biological Diversity*, The Convention on Biological Diversity, Strategic Plan for Biodiversity 2011-2020, including Aichi Biodiversity Targets, New York Declaration on Forests, IFC Performance Standard 6, High Conservation Values, High Carbon Stock Approach
Labour Rights	Employment Act 1955*, Children and Young persons (Employment) Act 1966*, International Labour Standards by International Labour Organizations, IFC Performance Standard 2
Human Rights	United Nations Guiding Principles for Business and Human Rights, UN Declaration on the Rights of Indigenous Peoples including Free, Prior and Informed Consent (FPIC), IFC Performance Standard 4, IFC Performance Standard 5, IFC Performance Standard 7
Pollution (Water, Air, etc)	The New Ambient Air Quality Standard*, National Water Quality Standards*, IFC Performance Standard 3, The AWS International Water Stewardship Standard

* denotes national policy/laws

Exclusion list

44. The IFI could develop a checklist of highly sensitive areas/industries that have been accepted by a universal convention, which it should not finance or invest in. The list could be developed based on geographically location, type of biodiversity, industry and others.
45. In developing this exclusion list, the IFI needs to consider micro and macroeconomic factors that would affect the economic development of the country. Where direct exclusion would result in a severe negative impact to the economy in the immediate period, the IFI should consider mitigation strategies including collaborating with relevant stakeholders to possibly devise a strategy that would reduce the negative impact and align the national economic agenda towards a more sustainable goal. This may include providing technical and financial assistance to assist the customer to transition towards sustainable practices.

Table 6: Example activities on exclusion list⁶⁰

Issue / Sector	Activity
Biodiversity loss and deforestation	<ul style="list-style-type: none"> • World heritage sites as classified by UNESCO • Wetlands on the Ramsar list • Areas as per The International Union for Conservation of Nature (IUCN) categories I to IV • Key Biodiversity Areas

⁵⁹ A summary of the main related policy/plan/programme in Malaysia is provided in Appendix: Resources and Tools.

⁶⁰ IFC Exclusion List (2007) <http://www.ifc.org/exclusionlist>, "Shaping the Future of Sustainable Finance: Moving the Banking Sector from Promises to Performance" <http://assets.wwf.org.uk/downloads/sustainablefinancereport.pdf>

Issue / Sector	Activity
	<ul style="list-style-type: none"> • Endangered species of wild flora and fauna as per Convention on International Trade in Endangered Species (CITES), and the Convention on the Conservation of Migratory Species of Wild Animals (CMS or Bonn Convention) and IUCN Red List of Threatened Species • Logging of or trade in illegally harvested or uncertified timber as well logging in uncertified primary forest • High conservation value forests • High Carbon Stock (not applicable to high forest cover countries) • Planting on peatland • Commercial animal testing, non-healthcare related
Labour Rights	<ul style="list-style-type: none"> • Activities causing human rights violations including child labour, forced labour, trafficked labour
Human Rights	<ul style="list-style-type: none"> • Activities resulting in the infringement of the rights of indigenous and/or vulnerable groups without their Free Prior and Informed Consent (FPIC)
Water	<ul style="list-style-type: none"> • Activities which endanger local water security
Pollution	<ul style="list-style-type: none"> • Activities that cause pollution (e.g. release of untreated wastewater, pollution of soil and waterways with untreated organic content etc.)

(II) Impact-based risk measurement

46. The IFI needs to develop a robust measurement approach in order to provide itself with a complete and accurate understanding of the impact-based risks associated with the financing and investment activities.
47. The IFI should establish clearly defined criteria and factors to be considered in the impact-based risk measurement. The methodology should be comprehensive and consider the impact to micro and macro factors e.g. towards the customer, environment and society.
48. In measuring the positive and negative impacts, the IFI may need to utilise both quantitative and qualitative measures. As far as possible, the IFI should use data-driven measures. For quantifying the impact and decision-making, the IFI should consider positive and negative impacts from each financing or investment activity, independently, and not offsetting the two. The negative impact could serve as a baseline in the determination of acceptable activities (refer to section on Exclusion list).
49. It is acknowledged that some impact-based measures on E&S factors would rely heavily on scientific measures. These measures may require IFI to apply assumptions in order to quantify such impacts in a monetary sense. In this regard, any assumptions and judgment-based estimates involved in the measurement should be reviewed periodically to ensure its appropriateness and relevance.
50. The impact-based measures, especially climate related would be important to improve the IFI's risk prediction models such as for stress testing purposes⁶¹. The

⁶¹ This is critical to facilitate the IFI's preparedness against the financial impact of physical and transition risk.

impact-based measures would provide a feedback loop when the IFI develops its VBI strategy, credit risk strategy and credit risk policy.

Table 7: Examples of impact metrics⁶²

Issue/Sector	Impact metrics at customer/transaction level ⁶³	Risk level ⁶⁴
General	<ul style="list-style-type: none"> • Area of land indirectly and directly controlled by the organisation and under sustainable cultivation or sustainable stewardship • Tons of certified production, % as total • Measured reduction in food loss and waste 	
Deforestation	<ul style="list-style-type: none"> • No. of hectares sustainably managed/restored • No. of hectares of peatland ecosystem restored • Frequency and results of biodiversity-related assessments⁶⁵ to evaluate the biological diversity present on the land directly or indirectly controlled by the organisation 	
Climate	<ul style="list-style-type: none"> • GHG emissions (scope 1, scope 2 and scope 3) reduced/avoided (MT) • Amount of reduction in energy consumption achieved as a direct result of energy conservation and efficiency initiatives employed by the organisation during the reporting period • Amount of produced/purchased energy consumed by the organisation from renewable sources during the reporting period 	
Water	<ul style="list-style-type: none"> • Volume of water used from regions with High or Extremely High Baseline Water Stress during the reporting period • No. of water efficiency projects executed • No. of water source vulnerability assessments implemented • % of operational assets covered by water stewardship approach • No. of community watershed partnerships 	
Pollution	<ul style="list-style-type: none"> • Water/soil quality improvements metrics • Amount of pesticides used during the reporting period on land area directly controlled by the organisation • Amount/proportion of recycled materials used in the organisation's products (including packaging) during the reporting period • Total reduction in waste generated by the organisation • Proportion of waste disposed by the organisation through 1) reuse 2) recycling, 3) incineration, 4) landfill 5) other means during the reporting period 	

⁶² <https://iris.thegiin.org/metrics/downloads>

⁶³ A table of themes and indicators applicable to various sectors is also available in the “Sustainability Reporting Guide” published in 2015 by Bursa Malaysia.

⁶⁴ The IFI would rank the risks associated with the sector based on factors such as the materiality and concentration of the IFI’s exposure in aggregate or transactional basis and consideration of stakeholders’ interests and/or national priorities/targets.

⁶⁵ https://www.profor.info/sites/profor.info/files/ForestTrends-SBIA-Part3_0.pdf

Issue/Sector	Impact metrics at customer/transaction level ⁶³	Risk level ⁶⁴
Human Rights/Local Communities	<ul style="list-style-type: none"> • % of small holders engaged in training/ certification programs • No. of farms/farmers adopting BMPs (Better Management Practices) • % improvements in farms productivity and income • Units/volume purchased from female individuals and individuals belonging to minority or previously excluded groups who sold to the organisation during the reporting period 	
Supply chain management	<ul style="list-style-type: none"> • Responsibly sourced/certified volume purchased from organisations who sold to the reporting organisation during the reporting period • Average agricultural yield per hectare of small holder farmers who sold to the organisation during the reporting period 	

Customer/investment acceptance and rating criteria

51. The IFI also needs to establish a clear customer/investment acceptance and rating criteria to facilitate the decision-making process. The customer acceptance and rating criteria are measures to assess the customer’s ability, both from the customer’s standpoint and transaction level, to meet the IFI’s policies (e.g. sector and issue-specific policies, exclusion list) based on the customer’s present commitment, capacity and track record.

52. Categorisation of the customer’s exposure (both at customer and transaction level) to impact-based risk factors should be clearly defined. IFIs should also identify the appropriate treatment or response for each category of impact-based risk rating. Both the results of the customer and transaction-level assessments should be considered when identifying the overall risk profile of the financing or investment engagement e.g. a transaction may be risky in nature, but the customer may have the capacity (in terms of strategy, policies, governance) to manage the impact-based risks of the transaction, as well as a positive track record. In this case, a medium risk profile could be assigned.

Table 8: Examples on descriptions of customer-level risks⁶⁶

Unacceptable Risk	The customer meets exclusion list criteria. The customer has no management procedures in place to mitigate E&S impacts/risks and no reporting on its E&S performance. Track record includes major irreversible E&S issues. No demonstrated commitment/willingness to improve.
High Risk	The customer has limited management procedures to mitigate E&S impacts, limited reporting on its E&S performance and has poor track record. Identified gaps in performance are significant but mainly reversible.
Medium Risk	The customer actively mitigates E&S risks relevant to its own activities. Track record is normal with minor/ resolved issues.

⁶⁶ Adapted from ING Environmental and Social Risk Framework (Refer to Appendix: Resources and Tools).

Low Risk	A customer actively applies best E&S practices not only to its own operations, but requires the same of its suppliers. The customer is certified by robust multi stakeholder certification systems ⁶⁷ , which address corresponding and material risks.
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Table 9: Examples on descriptions of transaction-level risks⁶⁸

Unacceptable Risk	Transactions that finance an activity on the exclusion list, or with irreversible E&S impacts. No mitigation actions can be developed or taken.
High Risk	Transactions with significant adverse E&S impacts that are sensitive, diverse, or unprecedented. A potential impact is considered sensitive if irreversible (such as loss of a major natural habitat), it affects vulnerable groups or ethnic minorities, involves involuntary displacement and resettlement, or affects significant cultural heritage sites. The impact may be controlled and prevented if a good mitigation strategy is implemented.
Medium Risk	Transactions with specific E&S impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures and international best practice. Potential adverse environmental impact on human population or environmentally important areas is less adverse than those of High Risk transactions.
Low Risk	Transactions with minimal or no adverse E&S impacts.

53. The table below demonstrates how different combinations of customer and transaction-level risks could be combined to create a single risk assignment. Note that in the example below, the customer-level risk, if higher, always takes precedence over the transaction-level risk.

Table 10: Example of impact risk matrix⁶⁹

Transaction risk	Customer risk			
	Low risk	Medium Risk	High risk	Unacceptable
Low Risk	Low	Medium	High	Unacceptable
Medium Risk	Low	Medium	High	Unacceptable
High Risk	Medium	High	High	Unacceptable
Unacceptable Risk	Unacceptable	Unacceptable	Unacceptable	Unacceptable

54. The approval decision could be defined as follows–
- (i) low risk cases can be automatically approved;
 - (ii) medium risk cases can be approved with conditions; and
 - (iii) high risk cases should be escalated to more senior levels of approval with conditions.
55. Where applicable, the assessment should be implemented at the customer’s group level unless the subsidiaries within the group apply policies related to the impact-based criteria differently (e.g. more stringent or less stringent). In this case,

⁶⁷ http://wwf.panda.org/our_work/markets/mti_solutions/certification/

⁶⁸ https://firstforsustainability.org/risk-management/managing-environmental-and-social-risk-2_2/components-of-an-esms/risk-categorization-and-managing-portfolio/

⁶⁹ Adapted from ING Environmental and Social Risk Framework (Refer to Appendix: Resources and Tools).

a separate assessment should be conducted to ensure appropriate assignment of risk.

Leveraging on external certification and verification

56. In measuring impact, the IFI may rely on independent, third party assessments, to provide a view on the impact created by the customers. In most cases, when a customer is certified against robust certification standards that address corresponding and material E&S risks, this generally provides enough comfort that the E&S risks are well-managed⁷⁰.
57. The IFI may rely on third party verification provided by local agencies such as assessments made by SIRIM QAS International Sdn. Bhd. and Department of Environment of Malaysia (DOE) (refer to section on Prioritising national interest and local regulations and standards). However, the IFI should aim to utilise robust independent multi stakeholder certifications where available.
58. Where neither a local nor independent multi stakeholder certification is available, the IFI may rely on other means of third party verification such as sustainability reporting assurance⁷¹ or external rating services⁷². The sufficiency of such verifications should be considered on case-by-case basis.

Table 11: Examples of certification and independent verifications

Sector/Issue	Sub-sector	Certification and Independent verification
General		<ul style="list-style-type: none"> MS ISO 14001: 2015 – Environmental Management Systems* MS 1722:2011 and OHSAS 18001 – Occupational Safety and Health Management Systems* MS 1900 Shariah-based Quality Management System Certification*
Climate		<ul style="list-style-type: none"> Science Based Targets Initiative
Water		<ul style="list-style-type: none"> AWS International Water Stewardship Standard Corporate context-based water targets
Agriculture	Palm Oil	<ul style="list-style-type: none"> Malaysian Standards Palm Oil (MSPO)* Roundtable on Sustainable Palm Oil (RSPO)
	Sugar	<ul style="list-style-type: none"> BONSUCRO
	Cotton	<ul style="list-style-type: none"> Better Cotton Initiative
	Coffee, Tea, Cocoa	<ul style="list-style-type: none"> Common Code for the Coffee Community (4C) Tropical Commodities Coalition for Sustainable Tea Coffee and Cocoa (TCC) Ethical Tea Partnership (ETP) World Cocoa Foundation (WCF) Rainforest Alliance
	Biomaterials	<ul style="list-style-type: none"> Roundtable on Sustainable Biomaterials (RSB)
Fisheries		<ul style="list-style-type: none"> Marine Stewardship Council (MSC) Aquaculture Stewardship Council (ASC)

⁷⁰ Provided that this certification matches the IFI's impact-based risk appetite for the particular sector and geography that the customer is involved in, there may be no need to do conduct further due diligence on the customer's commitment, capacity and track record, and the customer may be assigned a low risk rating (refer to section on Customer acceptance and rating).

⁷¹ Such as those provided by DNV GL and audit firms.

⁷² Such as those provided by Sustainalytics and MSCI ESG Ratings.

Sector/Issue	Sub-sector	Certification and Independent verification
Forestry		<ul style="list-style-type: none"> Malaysian Timber Certification Scheme - Programme for The Endorsement of Forest Certification (MTCS-PEFC)* Forest Stewardship Council (FSC)
Mining and Metals		<ul style="list-style-type: none"> World Gold Council Conflict-free Gold Standard Kimberley Process Certification Scheme (KPCS) Aluminium Stewardship Initiative (ASI) Initiative for Responsible Mining Assurance (IRMA) RJC Chain of Custody (CoC) Certification
Infrastructure		<ul style="list-style-type: none"> Sustainable INFRASTAR* The Standard for Sustainable and Resilient Infrastructure (SuRe®) GRESB CEEQUAL
	Transport	<ul style="list-style-type: none"> Greenroads Certification
	Hydropower	<ul style="list-style-type: none"> Hydropower Sustainability Assessment Protocol
	Buildings	<ul style="list-style-type: none"> Green Building Index*

*denotes national certification

Table 12: Examples of certification/standards for investment instruments

Instrument	Certification/standards
Sukuk	<ul style="list-style-type: none"> Sustainable and Responsible Investment (SRI) Sukuk framework*
Bond	<ul style="list-style-type: none"> ASEAN Green Bond Standards* Green Bond Principles Social Bond Principles Sustainability Bond Guidelines
Equities	<ul style="list-style-type: none"> FTSE4Good Bursa Malaysia Index*

*denotes national certification

(III) Impact-based risk management and mitigation

59. The IFI needs to establish a comprehensive set of impact-based risk management and mitigation strategies that is effective in minimising financial and reputational impacts to itself, arising from the failure of its counterparties to meet the impact-based conditions imposed. For clarity, impact-based risk management is not the management of problem credits as defined in *Credit Risk*. Impact-based risks may or may not result in immediate non-payment/recoverability of the financing/investment.
60. It is important to note that this process may also present business opportunities to the IFI to nurture its customers by promoting better and more sustainable solutions rather than out-right rejecting the customers. However, the IFI may need to exit from the transaction should the customer persistently fail to comply with the IFI's policies especially when the impact-based risk is too high.
61. The IFI should undertake management and mitigation of the impact-based risks in a structured and targeted manner – including employing relevant financial tools such as takaful and establishing effective monitoring of action plans, with a focus on improving impact outcomes and obtaining feedback to further strengthen the IFI's VBI strategy, credit risk strategy and credit risk policy.

62. The IFI needs to perform the assessment of appropriate customer-nurturing strategy and impact-based risk mitigation holistically. This can be done by taking into account relevant factors such as customer's commitment to sustainability, repayment capacity and quality of available risk mitigation tools. Essentially, the IFI should maintain objectivity/balanced⁷³ view when evaluating the impact-based risk vis-à-vis traditional credit risk factors to ensure the IFI's safety and soundness.
63. Based on the risk level assigned (refer to section on Impact-based risk measurement), the IFI should clearly identify conditions for approval that may include the development of time-bound action plans for the customers to improve their performance and align to the IFI's policies, penalties in the case of non-compliances or regular impact reporting requirements. Based on the conditions, appropriate covenants should be included into the financing or investment agreements.
64. The IFI should also consider the impact of the chosen mitigation strategy on other risks, directly or indirectly, to avoid giving rise to new unattended risks.

Nurturing programme

65. The IFI needs to develop a robust customer-nurturing strategy that would effectively support the customer's transformation towards adopting and enhancing their existing sustainability practices and consequentially deter customers from failing to comply with the IFI's impact-based terms and conditions. Such nurturing programmes may involve–
- (i) providing capacity building and training activities for specific groups of clients e.g. small and medium enterprises (SMEs);
 - (ii) facilitating collaboration with strategic partners in E&S impact areas;
 - (iii) linking costs of capital and access to capital with sustainability performance through incentives and disincentives, e.g. the profit rate for financing approved, or actual disbursement is subject to improvement in customers' sustainability practices (as adopted by Triodos, ING with its customer Wilmar and BNP Paribas with its customer Danone);
 - (iv) providing relevant advisory and infrastructure; and
 - (v) offering green financial products and services.

Exit mechanism

66. The design of an effective exit mechanism is meant to safeguard the IFI's interest in the event that the customers fail to comply with the IFI's impact-based terms and conditions. This involves the IFI incorporating contractual terms and conditions that would initiate the exit process should the customers fail to meet certain impact-based criteria and/or adhere with the action plans for remedy/rectification that are within the customers' control.
67. In designing the appropriate exit mechanism, the IFI should take into consideration the following aspects–

⁷³ See footnote 51. For example, the IFI needs to consider the cost benefit analysis of providing additional financing for green-improvements and the impact on the customer's financial position.

- (i) clear and transparent description of event(s)/indicator(s) that would initiate exit by the IFI;
- (ii) clear and transparent identification of entity/person(s) that would be held accountable – for example initiating legal action against the incorporated company and not extending any action to employees;
- (iii) exit strategy commensurate with severity of event/incident – for example consideration should be given as to whether connected accounts should be closed e.g. personal accounts of individuals who own or influence a non-compliant business;
- (iv) alternative strategies in the case when an exit cannot be executed within an agreed period – for example identify cause of the delay, revised exit date, additional risks involved, and further mitigation strategies if necessary in the meantime.

(IV) Impact-based risk monitoring and reporting

68. The IFI needs to establish a robust monitoring and reporting process to identify changes in the impact-based risks and ensure escalation could be conducted in a timely manner to appropriately support oversight and decision-making by the Board and senior management.
69. An effective monitoring process would enable the IFI to identify early signs of deteriorating or increasing negative impact. The IFI should also have in place appropriate mechanism to monitor new developments in the related industries, which are exposed to impact-based risks such as, new scientific research findings on sustainability impact and new standards and regulations issued by relevant local and international authorities/agencies.
70. The frequency of monitoring the impact-based risks created by customers should commensurate with the nature of the financing or investment activities, the level and complexity of credit exposure to the IFI. In general, the IFI should monitor the customer/transaction-level exposures periodically–
- (i) as part of periodic financing/investment reviews;
 - (ii) when previously agreed remedial/ rectification action is due; and/or
 - (iii) when there are material changes to the underlying business engagement e.g. negative news, change in local standards/regulations.
71. The IFI may also consider establishing an appropriate complaint/grievance mechanism that clearly specifies the types of complaint/grievance that can be submitted by external stakeholders against the IFI's customers and the process that will be taken by the IFI to address the complaint/grievance⁷⁴. For example, as part of the terms and conditions of the financing provided to a customer for a property development project, the IFI may include a covenant prohibiting the use of illegal immigrants. The IFI may establish a communication channel that will allow civil societies or NGOs to report incidence of the customer employing illegal immigrants knowingly.

⁷⁴ Effective complaint/grievance mechanism can help mitigate reputational risk arising from public protests, negative press, etc.

Aggregation – transactional versus portfolio

72. The IFI should have in place appropriate policies to facilitate the monitoring of the impact-based risks of its customers on an aggregate basis to better identify and measure the potential losses, including loss of stakeholder support, arising from the exposure of the impact-based risks.
73. The aggregation should appropriately segment the exposures based on their characteristics both at a transactional (type of financing or investment) and portfolio level (type of sector). The IFI should monitor its portfolio level exposure to key cross cutting risks e.g. deforestation, exploitation, climate risk, water risk.
74. The IFI should consider setting portfolio level targets in the context of national/local targets and/or international standards and best practices on sustainability. Such targets should focus on continuous improvement and be of a SMART nature (Specific, Measurable, Achievable, Relevant and based on science and Time bound) with the ultimate goal of aligning the IFI’s portfolio and refining its VBI strategy and risk management practices to the national/local standards and ultimately international standards and best practices.

Table 13: Examples of portfolio-level targets

Issue	Portfolio-level targets
General	<ul style="list-style-type: none"> • % of clients that are covered by time bound plans to achieve commitments (e.g. zero deforestation, no human rights, water stewardship approach, commodity certifications) • % of clients certified by credible sustainability standards
Deforestation	<ul style="list-style-type: none"> • Zero deforestation commitment by X date
Climate change	<ul style="list-style-type: none"> • Reduction of GHG emissions by X% by Y date • Allocating X RM million to renewable energy and energy efficiency solutions by Y date • % of fossil fuels in financed energy mix to decrease by X% by Y date • % of financed emissions scope1,2,3 to decrease by X% by Y date • Aligning portfolio with science based targets for climate risk
Water	<ul style="list-style-type: none"> • Aligning portfolio with Corporate context-based water targets
Labour and Human rights	<ul style="list-style-type: none"> • All clients in portfolio perform in accordance with ILO and UNGP by Y date

Impact-based risk reporting

75. The IFI should establish adequate policies and procedures for the impact-based risk reporting and disclosure where the scope, context and level of granularity and frequency of the reports/disclosure are appropriately tailored to the needs of the different groups of users of the reports (internal and external). The impact-based risk reporting policies should be embedded as part of the IFI’s comprehensive reporting and disclosure framework.
76. For reporting to the Board and senior management, the IFI should ensure that the information provided includes critical insights on impact-based risks and material issues, and such information is effectively integrated into the overall credit risk

reporting to ensure that the deliberation and decision-making process could be conducted with a comprehensive set of information.

77. The information included in the impact-based risk reporting may include the following⁷⁵ –

- (i) details of governance framework and impact on business strategies;
- (ii) description of key impact-based risks affecting the IFI e.g. key cross-cutting issues in sensitive sectors;
- (iii) information about processes that incorporate impact-based risk requirements into customer acceptance decisions (i.e. methodologies and criteria underpinning the decision-making processes of customer claiming to deliver positive impact or to reduce negative impact) and client engagement and monitoring processes; and
- (iv) at the portfolio level strategy and reporting, the IFI should consider providing transparency on –
 - processes for periodical review of portfolio exposures to climate-related risks and other E&S issues e.g. deforestation or human rights risk across the portfolio, and disclose methods used;
 - strategy to manage E&S risks to align portfolio with national/local and ultimately international standards and best practices on sustainability and supporting science-based targets where applicable;
 - where such alignment is yet to be achieved, report on time bound targets and progress towards them, if applicable;
 - aggregated customer/transaction-level assessment results e.g. number of assessed transactions, escalation, approval with conditions
 - impacts achieved by the activities, projects and programs.

78. When disclosing impact-based results which are not linked to financial data e.g. employment numbers, income growth, the IFIs, whenever possible, should use figures/measures that can be verified externally e.g. leveraging on quantification by third parties and/or recognised agencies.

79. The IFI should take cognisance of the importance of providing fair and transparent information for the consumption of external stakeholders to trigger intended stakeholder activism (refer to section on Overview)⁷⁶ and avoid “greenwashing”⁷⁷ or “impact washing”⁷⁸.

⁷⁵ The IFI should refer to existing international reporting frameworks such as the TCFD, the Integrated Reporting Framework, the GRI G4 Standard (Financial Sector Supplement), SASB financial sector standards and the proposed impact-based disclosures by the Islamic Financial Services Board (IFSB), published in Revised Standard on Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (Banking Segment).

⁷⁶ Also elaborated in the *Implementation Guide for VBI*.

⁷⁷ 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.

⁷⁸ An entity is considered to be involved in “impact washing” when it partakes in practices that are seen to have a positive impact in order to hide or mask other unpopular practices which create negative impact.

Appendix: Resources and tools

A. National policy/plan/programme^{79,80}

Document	Description
Eleventh Malaysia Plan (2016-2020)	Policy initiatives in the Eleventh Malaysia Plan are formulated to shift the method of development from conventional to a greener method (Green Growth) that will ensure the socioeconomic development is pursued in a more sustainable manner. Malaysia targets to be a high-income nation by 2020 with regard to low carbon, resource efficient, and socially inclusive aspects. Environmental areas are identified in the Eleventh Malaysia Plan include, conserving natural resources for present and future generations, adopting the sustainable consumption and production concept, strengthening the enabling environment for green growth, and strengthening resilience against climate change and natural disasters.
Second National Physical Plan (NPP II, 2010-2020)	This is a long-term strategic framework for national spatial planning including measures requires shaping the direction and pattern of biodiversity conservation and development, including land-use planning. The main objectives of NPP II are to tackle climate change; conserve natural and biological resources; establishing carbon sinks, sustainable forest and water management.
National Policy on Biological Diversity	The policy aims to transform Malaysia into a leading nation in research, conservation, and utilization of tropical biological diversity by the year 2020. The main objectives of the policy are; to optimize economic benefits from sustainable utilization of biological diversity; to maintain and improve environmental stability for proper function of ecological systems; to enhance scientific knowledge and educational, social, cultural, and aesthetic values of biological diversity, to ensure long-term food security for the nation; and focuses on biosafety in the development and application of biotechnology.
National Policy on the Environment	The Cabinet approved this policy on October 2002. It was formed to continue the economic, social and cultural progress of Malaysia and enhancement of the quality of life of its people, through environmentally sound and sustainable development. The policy aims to integrate environmental considerations into development activities and in all decision-making processes, to foster long-term economic growth and human development and to protect and enhance the environment. It complements and enhances the environmental dimension of other existing national policies, such as those on forestry and industry and take cognizance of international concerns.
National Mineral Policy 2	The objectives of the National Mineral Policy 2 are: to ensure the sustainable development and optimum utilisation of mineral resources; to promote environmental stewardship that will ensure the nation's mineral resources are developed in an environmentally sound, responsible and sustainable manner; to enhance the nation's mineral sector competitiveness and advancement in the global arena; to ensure the use of local minerals and promote the further development of mineral-based products; and to encourage the recovery, recycling and reuse of metals and minerals.

⁷⁹ Extracted from the "Roadmap for System of Environmental-Economic Accounting 2016-2020, Malaysia" published February 2017 by the Department of Statistics, Malaysia. Available online at <https://www.dosm.gov.my>

⁸⁰ Also see list at <https://www.mestecc.gov.my/web/en/policies-roadmaps/>

Document	Description
National Agro-food Policy (2011-2020)	The policy was introduced which focuses on improving the efficiency of the agro-food industry along the value chain for the industry to be more productive, competitive, and knowledge-intensive. This approach consist of 8 main ideas: The ideas are food security (adequacy, availability, safety, and affordability); high-valued agriculture development; development of sustainable agriculture; cluster dynamic agriculture (maximize revenue generation); private sector investment is the catalyst for the transformation of modern agriculture; human capital and informative smart agriculture; modernization of agriculture (through research and development (R&D), innovation, and technology); and advantages of agriculture support services.
National Water Resources Policy (NWRP)	The Tenth Malaysia Plan (2011-2015) highlighted the need to have a NWRP. NWRP will adopt measures to ensure the sustainability of water resources to achieve water security. The policy requires forging of partnerships between all levels of government and stakeholders to ensure that water resources are made a national priority.
Solid Waste Management Policy	The policy's objectives are to have a cost-effective and integrated solid waste management that include transportation and collection, intermediate treatment and disposal; to reduce solid waste of domestic, commercial, institution community, industrial, and construction through 3R; cost-effective and efficient services through privatization, efficient regulation, and uniform standards; selection of technology proven to be environmentally friendly; ensuring conservation of environment and public health; and establishing institutional and legal framework for solid waste management.
National Policy on Climate Change	The Cabinet approved this policy on November of 2009. It was formed to ensure climate-resilient development to fulfil national aspirations for sustainability. The objectives are to mainstream the climate change through wise management of resources and enhance environmental conservation resulting in strengthened economic competitiveness and improved quality of life; to integrate responses into national policies, plans, and programmes to strengthen the resilience of development from arising and potential impact of climate change, and to strengthen the institution and implementation capacity to better harness opportunities to reduce negative impacts of climate change.
National Renewable Energy Policy and Action Plan	This policy document is developed to enhance the use of renewable energy resources which contributes to sustainable socioeconomic development and national electricity supply security. Five objectives of the policy are determined which include: to increase renewable energy contribution in the national power generation mix, to ensure reasonable renewable energy generation cost, to conserve the environment for future generation, to facilitate the growth of the renewable energy industry, and to enhance awareness on the role and importance of renewable energy.
Green Technology (GT) Policy	The objectives of the policy are: to minimize growth of energy consumption while enhancing economic development; to facilitate the growth of GT industry and enhance its contribution to national economy; to increase national capability and capacity for innovation in GT development and enhance Malaysia's competitiveness in global arena; to ensure sustainable development and conserve environment for future generations; to enhance public education and awareness on GT and encourage its widespread use.

B. References and toolkits

1. Sector and issues policies

- a. <https://www.societegenerale.com/en/measuring-our-performance/csr/responsible-finance>
- b. <http://www.anz.com/about-us/corporate-sustainability/customers/responsible-business-lending/policies/>
- c. <https://www.sc.com/en/sustainability/position-statements/>
- d. <https://www.hsbc.com/our-approach/risk-and-responsibility/sustainability-risk>

2. Exclusion list

- a. https://www.abnamro.com/en/images/Documents/040_Sustainable_banking/060_Strategy/ABN_AMRO_Exclusion_list.pdf

3. Credible certification standards and policies

- a. http://wwf.panda.org/our_work/markets/mti_solutions/certification/
- b. <https://www.ing.com/web/file?uuid=5a9af88a-b6a3-4e8a-ae8d-d192e7f8d7c9&owner=b03bc017-e0db-4b5d-abbf-003b12934429&contentid=42010>
(page 23)
- c. <https://www.db.com/cr/de/docs/DB-ES-Policy-Framework-English.pdf>
(page 9)
Extract:

- for palm oil, we require as a minimum, that the client is a member of RSPO. Furthermore, we would expect the client's operations to be certified in accordance with RSPO or the client's time-bound commitment to achieve RSPO certification in a reasonable timeframe but not later than 2025;
- for timber, we expect clients to be certified according to the Forest Stewardship Council (FSC) (preferred) or the Programme for the Endorsement of Forest Certification (PEFC);
- for other commodities such as beef or cotton we expect clients to be guided by industry best practices and initiatives such as the Global Roundtable for Sustainable Beef, the Cattle Agreement or the Better Cotton Initiative;
- a commitment to align management systems with recommendations of the Food and Agriculture organisation of the United Nations' (FAO) Code of Conduct for Responsible Fisheries and/or plans to attain the Marine Stewardship Council certification or any other equivalent certification.

4. Customer impact-based rating

- a. <https://www.ing.com/web/file?uuid=5a9af88a-b6a3-4e8a-ae8d-d192e7f8d7c9&owner=b03bc017-e0db-4b5d-abbf-003b12934429&contentid=42010>
(page 29-32)
- b. Positive impact rating:
<http://www.unepfi.org/positive-impact/positive-impact-manifesto/>

- c. <https://iris.thegiin.org/metrics/sets>

Extract:

Tools for positive impact rating	Details
B Impact Assessment (and GIIRS Rating)	Metrics used by the B Impact Assessment (and GIIRS Rating) to determine an overall rating of an organisation's social and environmental impact, irrespective of an organisation's geography.
PRISM	PRISM leverages IRIS metrics in support of greater consistency and to reduce the overall reporting burden for relevant stakeholders. By leveraging IRIS metrics, PRISM reinforces the relevance of a global measurement standard, while enabling adoption of its holistic platform for assessing the performance of impact investment funds.

5. Risk mitigating tools

- a. Insuring renewable energy

<https://www.zurich.com/en/sustainability/working-with-customers>

Zurich covers many renewable energy construction projects around the world. For example, Desert Sunlight is one of the largest photovoltaic solar farms in North America, and Zurich was the lead insurer providing builder's risk coverage. In Italy, Germany and Switzerland, Zurich provides customised coverage for private home owners and small to mid-size commercial companies to build renewable energy facilities, such as photovoltaic, solar thermal, biomass and geothermal installations. Zurich's Renewable Energy Generating Equipment policy covers loss of renewable energy generating equipment that a customer owns or operates.

- b. Insuring aquaculture sector from extreme rainfall

<https://www.swissre.com/reinsurance/property-and-casualty/solutions/parametric-solutions/first-parametric-aquaculture-insurance-solution-in-taiwan.html>

Swiss Re, together with Taiwan Fire & Marine Insurance, have jointly developed the first parametric aquaculture insurance solution in Taiwan. This insurance solution is launched in the Ping Tung County to help onshore fish farms transfer heavy rainfall risk through an insurance that is paid out when the County experiences extreme rainfall of over 480 mm for two consecutive days. It will protect grouper fish producers from flash flood, which may cause overflowing of onshore fisheries and escape of the fishes, resulting in a loss of fish stock.

6. Nurturing programmes

- a. Trainings and workshops for customers

<https://www.uob.com.sg/AR2017/documents/Full-Annual-Report-2017.pdf>
(page 37)

- b. Systematic E&S advice

<https://www.rabobank.com/en/about-rabobank/in-society/sustainability/for-business-clients/index.html>

c. Green products

<https://www.dbs.com/sustainability/responsible-banking/sustainable-finance/default.page>



Rabobank helping business clients become sustainable step by step to achieve sustainability development en-route to 2020

1. Sustainable client photo

Rabobank gives clients a clear picture of whether they are ahead or behind their sector competitors in the area of sustainability. This 'client photo', combined with advice, provides insight into the business strengths and weaknesses and the opportunities and threats in the market e.g., Rabobank provides relevant sustainability knowledge for the small business via mobile application.

2. Frontrunners come first

Rabobank is doubling the scope of its services for sustainable frontrunners. Sustainable initiatives are given priority access to financing within the standard risk and return requirements. Rabobank also, on request, develops new financial solutions in partnership with frontrunners with a view to optimally supporting their business success.

3. Developing a circular economy

We explore regional opportunities for organising the circular economy throughout the Netherlands. Another key activity involves launching, financing and taking part in initiatives that promote high-quality raw material recycling and sustainable chains.

4. Making financing sustainable.

Our clients are offered tailor-made financial solutions that help them gradually improve their sustainability performance. We introduce new products that form a direct link between our savers and investors and innovative sustainable businesses.

Source: Rabobank website⁸¹



ING nurtures its customers by giving loan with interest rate pegged to customer's sustainability performance

A portion of an existing US\$150mn revolving credit facility has been converted, with Wilmar set to pay less if it meets targets around areas including biodiversity, greenhouse gas emissions, renewable energy, social standards, bribery and corruption, and sustainable agriculture. Wilmar's performance will be tracked by Sustainalytics - a company that does sustainability and governance rankings and research - based on environmental, social and governance indicators.

ING measures the financing provided to sustainable projects and to clients who are environmental outperformers. This is reflected in the term

⁸¹ <https://www.rabobank.com/en/about-rabobank/in-society/sustainability/for-business-clients/index.html>

sustainable transitions financed, which has grown to over €35bn at year-end 2016.

Source: Online news website⁸²

7. Exit policies

- a. <https://www.ocbc.com/group/who-we-are/responsible-financing.html>

In addition, we may impose covenants in our credit facilities that require the borrowers to comply with ESG requirements. If the covenants are breached or our ESG expectations are not met, we will reassess the client relationships, including turning down transactions.

- b. <https://www.dbs.com/sustainability/responsible-banking/responsible-financing/default.page>

If any customer is suspected to be involved in undesirable ESG practices, we will promptly engage the customer. If the customer is not willing to take steps to adequately manage and mitigate the identified ESG risks, we are prepared to turn down the transaction or reassess the banking relationship

- c. HSBC's policy compliance in palm oil

Extract:



There may be exceptional circumstances where customers meet the spirit, but not the letter of this policy, or where enquiries about a customer's compliance are incomplete. Global Businesses must exit relationships, as soon as possible, with Non-Compliant customers, including:

- Customers expelled from RSPO (including those who terminate their membership during complaints investigations) or whose certification is withdrawn.
- Customers not on a credible path to meeting HSBC's policy deadlines.

Where a customer group also operates in other sectors, Global Businesses must:

- Not provide financial services directly supporting Non-Compliant companies;
- Actively engage with the controlling parent company, if a customer, to highlight the benefits of meeting this policy; and
- Submit a recommendation to their regional Reputational Risk and Client Selection Committee (RRCSC) as to whether HSBC should continue or close the relationship with the parent and the rest of the group. The review must take into account the scale and nature of any negative impacts and, if any relationship is continued, the restrictions proposed for any financing.

Continuing relationships will be rated Near-Compliant and subject to annual clearances and two-yearly referral to the RRCSC

Source: HSBC Agricultural Commodities Policy

⁸² <https://www.gtreview.com/news/sustainability/ing-pegs-wilmar-loan-to-sustainability-kpis/>

8. Monitoring and portfolio targets –

a. Periodic monitoring transaction/client level

<https://www.ocbc.com/group/who-we-are/responsible-financing.html>

Under our credit evaluation process, we conduct ESG risk assessment on borrowers at least once a year throughout the financing tenor. Additional assessments are conducted if and when significant ESG events arise.

b. Periodic portfolio level assessment on E&S issues

<https://www.uob.com.sg/AR2017/documents/Full-Annual-Report-2017.pdf>
(page 37)

We review our portfolio's ESG exposure periodically. As at 31 December 2017, all the borrowers in the eight ESG-sensitive industries had undergone the ESG risk assessment with relevant risks adequately mitigated and managed. The Bank had not had a significant concentration in any of the eight ESG-sensitive sectors, which collectively accounted for approximately 10 per cent of our total loan portfolio.

c. Portfolio level assessment on human rights

https://www.abnamro.com/en/images/Documents/040_Sustainable_banking/080_Reporting/2016/ABN_AMRO_Human_Rights_Report_2016.pdf
(page 24)

In our role as a financier, effective management of our salient issues depends on the successful identification and mitigation of human rights risks. ABN AMRO performs two types of human rights due diligence in its lending portfolio: value chain studies and company assessments. First, the bank identifies and assesses structural human rights impacts through value chain studies on diamonds, textiles, cocoa and copper

d. Reporting on energy mix

<https://www.ing.com/Sustainability/Our-Stance/Energy.htm>

e. Commitment to 2-degree scenario

<https://www.societegenerale.com/en/newsroom/societe-generale-strenghtens-its-commitments-in-the-fight-against-climate-change>

In line with the commitments made at COP 21, Societe Generale marks a new stage in its proactive climate policy, which aims to align its activities by 2020 with the International Energy Agency (IEA) scenario to limit global warming to 2°C.

f. Commitment to zero deforestation

<https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/sustainability/WestpacCCEActionPlan.pdf>
(page 13)

Agribusiness plays a fundamental role worldwide in feeding the global population, shaping health outcomes, driving economic growth, reducing poverty, and supporting livelihoods. We recognise that transactions in this sector need to consider a range of environmental impacts, including reducing emissions from deforestation and land conversion. It is for these reasons we have committed under both the Banking Environment Initiative's (BEI) Soft Commodities Compact, and the New York Declaration on Forests, to work with other organisations associated with this sector to achieve net zero deforestation by 2020.

9. Sustainability reporting

- a. <https://www.prudential.co.uk/~media/Files/P/Prudential-V2/reports/2018/esg-report-2018.pdf>
- b. http://www.aia.com/content/dam/group/en/esg/AIA%20Group%20ESG%20Report%202018_E.PDF
- c. <https://www.citigroup.com/citi/sustainability/data/finance-for-a-climate-resilient-future.pdf>
- d. <https://www.anz.com.au/about-us/sustainability-framework/environmental-sustainability/climate-change/>

End of document.