Rethinking ESG in a post COVID-19 world

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Foreword

“If you put a frog in water and slowly heat it, the frog will eventually let itself be boiled to death” - Charles Handy, ‘The Age of Unreason’.

This metaphor illustrates the dangers of ignoring changes until it is too late. It can be reflective of how we respond to issues on sustainability - if we don’t pay enough attention to it now, the impact on our world and our businesses may eventually become irreversible.

COVID-19 has upended societies, disrupted businesses and left millions unemployed. It illustrates the risks and scale of disruptions that we could face if we remain idle. The United Nations Secretary General has described COVID-19 as both a wake-up call and a dress rehearsal for the world of challenges to come - climate change above all.

Governments and businesses are taking heed. Investor groups and regulators are urging companies to set Net Zero emissions targets and plans, and hold them accountable through increased disclosure and shareholder resolution processes.

The number of regional governments, cities and businesses committed to reaching net zero emissions by 2050 has roughly doubled in less than a year to around 1,575 as of September 2020[1]. Closer to home, PETRONAS has taken the lead as the first state-owned Asian energy company to announce its aspiration to achieve Net Zero Carbon Emissions by 2050.

The Malaysian government's commitment to catalysing the sustainability agenda is reflected in the recently announced budget measures. The **2021 Budget, which has a special focus on sustainability**, is aligned with the United Nations’ (UN) 17 Sustainable Development Goals (SDGs) and is designed to move Malaysia towards a more sustainable future. Among the measures introduced in the Budget are our first sustainability bonds and the extension of the Green Technology Financial Scheme, which will encourage participation from the private sector.

In an effort to emerge stronger from COVID-19, there are **intensifying calls for more sustainable practices.** It will require combined efforts from businesses, the government, and the public to plan and drive improvements in environmental and social practices over the long term. This needs to start today for it to have the necessary impact.

It is understandable for industries and companies to prioritise survivability over sustainability in light of the pandemic. However, as companies begin to plan their post-COVID-19 future, investors and bankers will assess sustainability commitments before arriving at investment decisions.

The time is now for you to seize the opportunity to future proof your business with a **holistic strategy to address Environmental, Social and Governance (ESG)** considerations and in doing so, you will be taking steps to avoid becoming a frog in boiling water.

Dato' Mohammad Faiz Azmi

Executive Chairman
PwC Malaysia

[1] Source: The United Nations Framework Convention on Climate Change

Key highlights

The risk of climate change and diminished social prosperity are making investors, governments and businesses rethink their Environmental, Social, and Governance (ESG) commitments.

Highlighted below are the factors driving the call for sustainability and how to get ready to meet the sustainability challenges ahead.

1. Investors, governments and consumers are driving the ESG wave

Institutional investors increasingly prioritise non-financial impacts, call for corporates to disclose and address ESG risks

- Climate Action 100+ (represents investors managing US$47 trillion in funds) urging companies to set net zero emissions targets and plans, and hold them accountable.
- Global investors, such as Calpers, Schroders and DWS call for mandatory inclusion of climate risks in financial accounts.
- The International Accounting Standards Board (IASB) in November 2019 reinforced the point that climate change, if material, would need to be factored into financial reports.

There is increasing evidence that suggests a correlation between ESG and company performance

- MSCI World Socially Responsible Investing (SRI) Index returns outperformed the MSCI World Index by 507bp in the first nine months of 2020.
- In the wake of the COVID-19 sell off, ESG-aligned assets outperformed the market - as highlighted in a Bloomberg analysis (the average ESG fund declined by 12.2% in 2020, less than half of the decline of the S&P 500)
- The performance gap between ESG and non-ESG stocks could continue to widen as societal acknowledgment of sustainability risks further shifts investors' sentiments in favour of ESG investments.

The regulatory and legislative momentum behind ESG has strengthened in recent years

- The COVID-19 crisis has stimulated a strong response from policymakers on the importance of ESG. e.g. European Union (EU) is allocating at least 30% of the Budget and Recovery Fund to help achieve the Green Deal, a set of policy initiatives aimed at making Europe climate neutral by 2050.
- Greater scrutiny over Malaysian products e.g. palm oil and rubber gloves over labour and sustainability concerns.
- Malaysia has introduced sustainability policy and incentive schemes, for example: Large Scale Solar, green technology, and socially responsible investment fund.

Public awareness in ESG related risks has catapulted sustainability to the top of the global agenda

- In PwC's Global Consumer Insights Survey 2020, 52% of respondents in Southeast Asia say they expect businesses to be accountable for their environmental impact.
- Society is assigning an increased level of importance to sustainability and ESG. COVID-19 has accelerated this shift, bringing the real-life impacts of overlooking ESG concerns into the spotlight.

2. Climate change accelerates ESG risks, yet there are also opportunities. Only those that are prepared will be able to tap such opportunities

Climate risk factors

The period of relative climate stability may be coming to an end

- Global temperature in August was 2.14°C hotter than the average month recorded since 1880 - *NASA's Goddard Institute for Space Studies*

- *UN's Intergovernmental Panel on Climate Change (IPCC)* reported that a 2°C average global temperature increase from pre-industrial levels would exacerbate extreme weather and loss of ecosystems.

Asia at higher risk of climate change

- 77% of Southeast Asians living along the coast or in low lying river deltas will be threatened by rising temperature and sea levels - *Center for Strategic and International Studies*

- Asia's economy will be 2.6% smaller by 2050 due to lack of climate resilience - *EIU Viewswire*

Malaysia, located near the equator, is at risk of higher rise in temperature

- Sea levels in Malaysian waters have been increasing at an average rate of 3.67 ± 0.15 mm/year, higher than the projected global sea-level rise of 1.7 to 3.1 mm/year.

- Extreme weather conditions, higher temperatures, and sea level rise could lead to food security issues like rice production and more volatile palm oil prices.

Industry risks and opportu-nities

Untapped ESG opportunities in Malaysia

- Penetration of renewable energy is still far from target; electric vehicle (EV) sales and construction of green buildings are still very low. Electricity, transportation and construction are the largest greenhouse gases (GHG) emitting sectors in the country.

- Investment in these areas are crucial to offset Malaysia's growing GHG emissions, which have doubled in 20 years (1997 to 2017).

Malaysia's industries are exposed to ESG risks

- 10.3% of total assets of banks (or around RM287 billion) are potentially exposed to climate change. Sectors with high exposures include construction, transport, agriculture and utilities - *Bank Negara Malaysia*

- Exports to developed countries, which account for 48% of Malaysia's exports (RM473 bln), are susceptible to transition risk*. Malaysia is a key component of the global supply chain.

Opportunities in the low carbon economy

- Making energy greener could increase global GDP by US$98 trillion by 2050 - *United Nations Development Programme*
- Size of the ESG market globally:
  - Nature-based solutions: US$1.2 trillion
  - Financing UN's Sustainable Development Goals: US$2.5 trillion
  - Renewable energy: US$10 trillion (cumulative investments 2020-2040)

  (Various sources)

* Transition risks include policy changes, reputational impacts, and shifts in market preferences, norms and technology as we move towards a low carbon economy

3. ESG has yet to be a core focus for companies. Corporates and boards need to rethink ESG to future proof their businesses

73% of Malaysian companies mentioned the Sustainable Development Goals (SDGs) in their reporting; only **20%** had included the SDGs in their published business strategy.

- PwC's SDG Reporting Challenge

Company

Corporates need to put ESG at the forefront to future proof their business against increasing sustainability risks:

1. Identify the risks that your organisation faces as well as the potential opportunities
2. Identify your key stakeholders (e.g. investors, customers) and their sustainability concerns
3. Determine what is most material in order to prioritise key issues to focus on
4. Build strong governance that ensures ESG accountability is driven throughout the organisation, starting from the top.
5. Develop an action plan to address these issues and communicate it with your stakeholders

Board

Boards need to look at ESG risks and strategies as part of its roles as provided by the Malaysian Code on Corporate Governance (MCCG), which includes:

1. Ensuring the strategic plan includes strategies on economic, environmental and social considerations underpinning sustainability
2. Understanding the principal risks of the company's business and recognising that business decisions involve assuming appropriate risks
3. Setting the risk appetite and appropriate risk management framework to identify, analyse, evaluate, manage and monitor significant non-financial risks

In addition, the board should establish clear Terms of Reference on ESG, outlining the roles and responsibilities of the board.

Clean energies such as gas and renewable energy are expected to enjoy the biggest growth in demand of above 30% each compared to oil (9% growth) and coal (1% decline) in the same time period. The hastened pace of the energy transition has seen a greater focus on energy from clean and sustainable sources. As more and more oil and gas (O&G) producers integrate greater sustainable development practices into their operations, the evolution of its businesses towards cleaner energies such as natural gas, renewable energy and other greener energy sources are inevitable.

For PETRONAS, sustainability is not just a ‘licence to operate’ but is integral in supporting our current business resilience as well as to unlock opportunities for new topline creation. Therefore, our efforts are undertaken in a holistic approach that balances Environment, Social and Governance (ESG) considerations aligned to our Statement of Purpose – a progressive energy and solutions partner enriching lives for a sustainable future.

Tengku Muhammad Taufik
President and Group Chief Executive Officer
PETRONAS

Content

1

Bringing ESG to the forefront

Rebuilding better

Winds of change

The term Environmental, Social and Governance (ESG) was first coined in 2005 in a landmark study titled "Who Cares Wins" which included guidelines on integrating ESG factors in businesses. It became the first sustainability scoring concept, adopted by large index providers and promulgated by the United Nations (UN) Principles for Responsible Investing (PRI).

ESG issues have gained considerable attention as the world discusses the impact of COVID-19. The pandemic has brought into focus systemic inequalities, such as access to healthcare and green spaces, connectivity to the internet, as well as work and education opportunities. These issues, if not properly addressed, can have exponential repercussions on society, which businesses rely on for their demand and supply of goods and services.

Chart 1:

Examples of ESG considerations

Environment	Resources and energy use, waste management and carbon emissions
Social	Human rights, fair labour standards in the supply chain, exposure to child labour, fair wages, workplace health and safety
Governance	Corporate duties and responsibilities, decision making process, transparency and disclosure, accountability

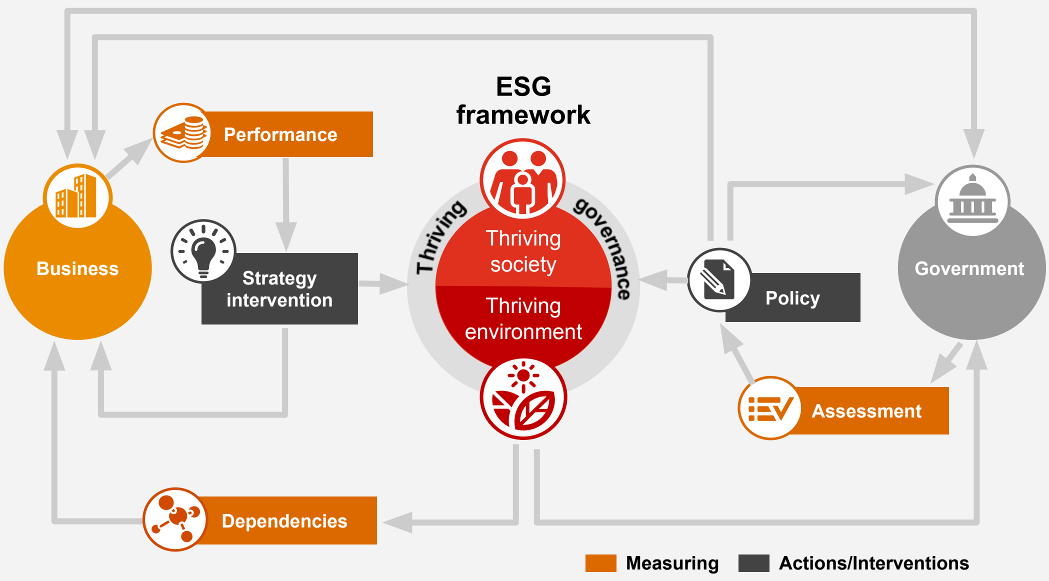
Chart 2: Interconnected - business in context

The **government** shapes and implements policies that support and protect the society and the environment.

While **businesses** integrate sustainability into their strategies, determining how they use resources and interact with society.

The **governance** structure (ESG framework) ensures the government and businesses do their part.

Failure to take into account ESG elements will heighten exposure of businesses to systematic risks.



Source: PwC Business through a new lens, 2016

Another notable development in ESG is the introduction of the UN Sustainable Development Goals (SDGs) in 2015 where 193 governments, including Malaysia, agreed to deliver 17 integrated global goals tackling major world issues by 2030.

The 17 SDGs aim to address challenges such as poverty, health, education and climate change. It emphasises good growth that delivers social and environmental value, as well as optimal economic benefit. SDGs can provide the framework for governments and businesses to deliver progress on our global challenges.

The top ESG issues faced today are largely environmental in nature due to the impact of climate change and regulatory requirements:

- The World Economic Forum (WEF) Global Risks Report 2020 puts climate change at the front and centre, where environmental concerns dominate the top long term risks by likelihood (see chart 3 below).
- Regulators are setting requirements for companies to identify and manage climate-related risks. In the United Kingdom, the Prudential Regulatory Authority has specific local regulatory expectations for managing climate risks.

While the term ESG covers much more than environmental issues, **we will be focusing on environment-specific elements of ESG in view of the pressing urgency for businesses to act on climate change**, albeit acknowledging that the three factors (environmental, social and governance) are interrelated and interdependent.

Driven by increased awareness about how climate change can affect economic growth, asset values, and financial markets, there is a paradigm shift towards ESG. Fundamental changes are already taking shape, with governments, regulators, investors and consumers getting behind the ESG agenda.

Here are some of the key catalysts driving the growth of ESG, that will be explored further in this chapter:

1. Investor expectations
2. Sustainability reporting
3. Regulations
4. Fiscal policies
5. Customer behaviour

Environmental-related issues dominated WEF top global risks for the first time in 2020

Chart 3: WEF 5 year trend of top 5 global risks by likelihood

Top 5 global risks	2016	2017	2018	2019	2020
	Involuntary migration	Extreme weather	Extreme weather	Extreme weather	Extreme weather
	Extreme weather	Involuntary migration	Natural disasters	Climate action failure	Climate action failure
	Climate action failure	Natural disasters	Cyberattacks	Natural disasters	Natural disasters
	Interstate conflict	Terrorist attacks	Data fraud or theft	Data fraud or theft	Biodiversity loss
	Natural catastrophes	Data fraud or theft	Climate action failure	Cyberattacks	Human-made environmental disasters

Environmental
Geopolitical
Societal
Technological

Source: WEF Global Risk Report 2020

1. Investor expectations

The COVID-19 pandemic has shown an increased scrutiny on corporations' responses to the pandemic, and their long term goals. No longer can they focus only on short term profit but must look at long term sustainability.

Amongst institutional investors, this has resulted in environmental and social factors having a greater influence over a company's future performance and valuation.

Investors also see a real risk of companies underperforming if they do not effectively integrate sustainability considerations into their strategy and supply chain. For example, returns on the MSCI World Socially Responsible Investment (SRI) index outperformed the MSCI World index by 507bps in the first nine months of 2020.

Tipping point towards sustainable investments

BlackRock, the world's largest asset manager, aptly put it in May 2020: "we are on the front end of a profound, long-term structural shift in global investor preferences toward sustainability that is not fully priced into the market today and may therefore drive outperformance during a long transition period".

This is evident from the surge in interest in sustainability funds. In the first half of 2020, global sustainable funds saw strong capital inflows of US$117 billion, versus a net outflow of US$30 billion for the broader fund universe, according to Morningstar.

> MSCI World Socially Responsible Investment index outperformed the MSCI World index by 507bps in the first nine months of 2020
>
> *MSCI*

Soaring interest from institutional investors

A Mercer 2020 European asset allocation insights report stated that:

- 89% of pension schemes were considering ESG risks to their investments, compared to 55% of funds in 2019.
- 54% of European pension fund schemes are considering the impact of climate change risks, up from 14% in 2019.

On reasons for considering climate change risks, the report stated that:

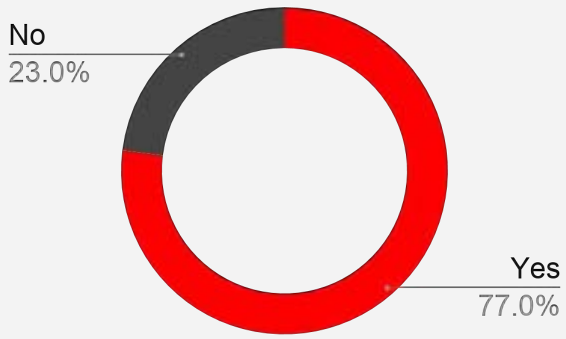
- 51% of pension schemes cited financial damage to investment returns, compared to 29% in 2019.
- 40% of pension schemes cited mitigating reputational damage

Close to 300 companies now have a commitment to achieve net zero emissions before 2050. This would mean investors may shun companies that do not change and rethink their strategy to be more sustainably driven.

PwC's European Sustainable Finance Report, "2022 - The growth opportunity of the century", revealed that a vast majority of institutional investors expect a convergence between ESG and non-ESG products by 2022

Chart 4: Institutional investors plan to stop investing in non-ESG products by 2022

Do you intend to stop investing in non-ESG products within the next 24 months? (institutional investors)



Source: PwC Global AWM Research as cited in PwC 2022: The growth opportunity of the century

What this means for boards

Institutional investors are pressuring companies to integrate ESG considerations into their corporate strategy and operations, with the purpose of mitigating future ESG risks, preserving and safeguarding the company's market value and assets.

In short, they are prioritising non-financial impacts alongside financial returns. Boards being stewards of a company's purpose, will need to prioritise and consider whether profit is the right or only measure of a company's progress against their purpose.

Michael Porter, a renowned strategist, added that "the purpose of the corporation should be value creation, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy. It will also reshape capitalism and its relationship to society".

Boards' roles and responsibilities in ESG are also outlined in the Malaysian Code on Corporate Governance (MCCG), which states that boards should:

- Ensure that the strategic plan of the company supports long term value creation and includes **strategies on** economic, **environmental and social considerations underpinning sustainability**
- **Understand the principal risks of the company's business** and recognise that business decisions involve assuming appropriate risks
- **Set the risk appetite** within which the board expects management to operate and ensure that there is an appropriate risk management framework to identify, analyse, evaluate, manage and monitor significant financial and non-financial risks

In addition, the board should **establish clear Terms of Reference on ESG**, outlining the roles and responsibilities of the board when it comes to sustainability.

Malaysia, getting on the sustainable investments wave

Here are some notable ESG initiatives that have been undertaken:

- Introduction of alternative green financing schemes such as Green Sukuk and the Green Technology Financing Scheme, to finance and stimulate sustainable projects.

- The Securities Commission (SC) launched the 'Sustainable and Responsible Investment Roadmap' publication in November 2019. Among the strategies outlined are:
  - Widening the range of Sustainable and Responsible Investment (SRI) instruments,
  - Building the SRI community; and
  - Building good governance

- A local chapter of the World Economic Forum (WEF) Climate Governance initiative was established in 2019, making Malaysia the second country in the world to have a local chapter. It aims to help local board members acquire sustainability skills and knowledge.

  The inception of Malaysia's Climate Governance was inspired by PwC's WEF Climate Governance report, "How to Set Up Effective Climate Governance on Corporate Boards"
- There is an increasing trend in Shariah compliant ESG funds launched this year, including Bank Islam's Robo-Intelligence Sustainable Shariah-ESG investing online platform and Maybank Global Sustainable Equity-i Fund.

Sustainability is critical to ensure relevance for any institutional investor going forward. We see a huge potential out of ESG and sustainability practices as evidence has shown that they provide resilient financial returns while enabling us to actively participate in creating workable solutions for the challenges faced during this increasing period of uncertainty.

While sustainability has always been at the heart of what EPF does, the time is ripe for us to be a force of positive change in moving from 'doing no evil' to actively 'doing good'. We have been and will continue to actively engage with our investee companies, relook into our voting policies, take a strong stance on companies that failed to comply, and come up with strong ESG rating tools.

We believe that we can have a good living by living good.

Alizakri Alias
Chief EPF Officer
Employees Provident Fund

2. Sustainability reporting

Companies need to reshape corporate reporting to meet investor needs

Sustainability information provided by companies until now has rarely been comparable, timely or consistent year-to-year. There's been a focus on gloss over substance, according to Accounting Today in August 2020.

However, investors find such information critical to understanding future business risks and prospects. There have been calls from global investors, such as Calpers and Schroders, for mandatory inclusion of climate risks in financial accounts.

BlackRock, has written to 577 companies in Asia, representing over 90% of MSCI index constituents (excluding Japan and Australia), putting them on notice that it expects greater disclosures on sustainability. Part of the issue is that global investors are under pressure from governments and asset owners to report their impact on people and the planet.

As an example, the UN Principles for Responsible Investment (PRI), a UN-supported network of investors, has made reporting against the Task Force on Climate-related Financial Disclosures (TCFD)[2] mandatory for its signatories from 2020.

This resulted in a 3.5 times increase in TCFD based investor reporting in the first quarter of 2020. Among local signatories to the PRI are Employees Provident Fund (EPF), Kumpulan Wang Persaraan (KWAP) and Khazanah Nasional Berhad.

> Many companies espouse the Paris Accord or the SDGs, but fail to set specific targets and measure their progress accordingly.
>
> *Alliance for Corporate Transparency*

[2] TCFD was created in 2015 by the Financial Stability Board (FSB) to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders.

Rapid evolution towards sustainability reporting

In response to the need for better corporate reporting from investors and regulators, there has been rapid development in sustainability/ESG reporting standards. The notable ones include:

1. The International Accounting Standards Board (IASB) issued a guidance in November 2019 to reinforce that climate change, if assessed to be material, would need to be included in financial reporting considerations.
2. In the UK, the Financial Conduct Authority (FCA) announced in March 2020 that companies on the Main Board of the London Stock Exchange must either make climate-related disclosures consistent with TCFD recommendations, or explain why not.
3. The European Commission is likely to announce new mandatory non-financial reporting requirements in the revised Non-Financial Reporting Directive (NFRD) in early 2021, to increase transparency in ESG reporting.
4. Bank Negara Malaysia (BNM) and SC are working towards wider adoption of the TCFD and pushing for the adoption of disclosure standards. Financial institutions are expected to integrate climate-related risks, for example, through voluntary disclosure of climate-related risks in line with TCFD recommendations.
5. There is a move toward a unified global approach to sustainability accounting standards with the support of leading global organisations including:
    - IFAC (International Federation of Accountants)
    - Proposed set-up of ISSB (International Sustainability Standards Board) - a sister board to IASB (International Accounting Standards Board) under the IFRS Foundation (International Financial Reporting Standards)
    - WEF and the International Business Council's push for integrated reports.

What's next for companies

Financial reporting has rigorous assurance requirements, further strengthened by long standing regulations and standards. In contrast, regulations and guidelines for non-financial reporting data is varied and still evolving.

With the value of intangible assets eclipsing tangible assets by a nine to one ratio (see chart 6), new non-financial regulations such as sustainability/ESG reporting will continue to gain significance.

Chart 5 below outlines some of the key initiatives companies and boards should take as they prepare for the new reporting environment.

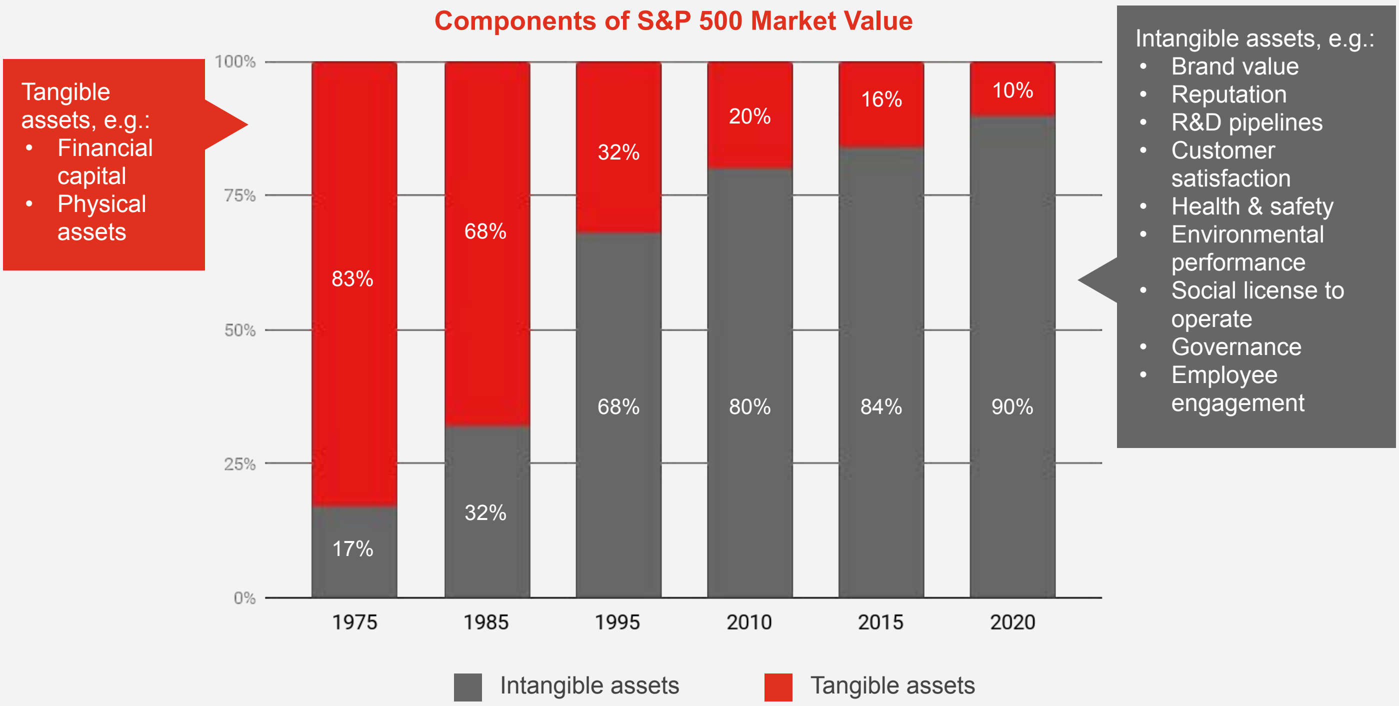
Chart 5: Preparing for the new ESG reporting environment

Companies need to define what their stakeholders need and decide on a relevant reporting framework	Companies' reporting need to be aligned with global standards to drive consistency and trust	Standards and expectations for sustainability/ ESG reporting should be as high as they are for financial reporting	ESG information needs to be verifiable (assured) to be trusted	Companies need to establish the sustainability/ ESG reporting framework - from strategy through execution

Source: PwC

Chart 6: Value of tangible assets vs intangible assets.

With intangible assets eclipsing tangible assets, disclosure of non-financial data on intangible assets needs better assurance and as much reporting rigour as financial data.



Source: Ocean Tomo, Ocean Tomo's Intangible Asset Market Value Study, 2020, with examples from PwC

3. Regulations

Environmental challenges increasingly dominate the news now, from forest fires to floods to irresponsible parties polluting the environment. Regulators are quickly stepping up to provide a sound framework to encourage and promote sustainable behaviors.

EU's Green Deal, resetting regulations

Europe can be a signaling post of potential changes in regulations, with EU leading the way with its Green Deal policy. Launched in December 2019, it sets the goal of becoming the first climate-neutral continent by 2050.

The Green Deal includes 50 actions to be implemented by 2021 through regulations related to climate, energy, circular economy, transportation, agriculture, financial services, biodiversity and waste management.

The impact of the Green Deal would be felt by countries trading with Europe. EU is considering imposing a tax on goods imported into the region by 2023 that would reflect the amount of carbon dioxide (CO_2) emissions attributed to their production. Companies exporting to Europe will need to proactively measure and mitigate their CO_2 footprint in the near future.

Pressure from trading partners

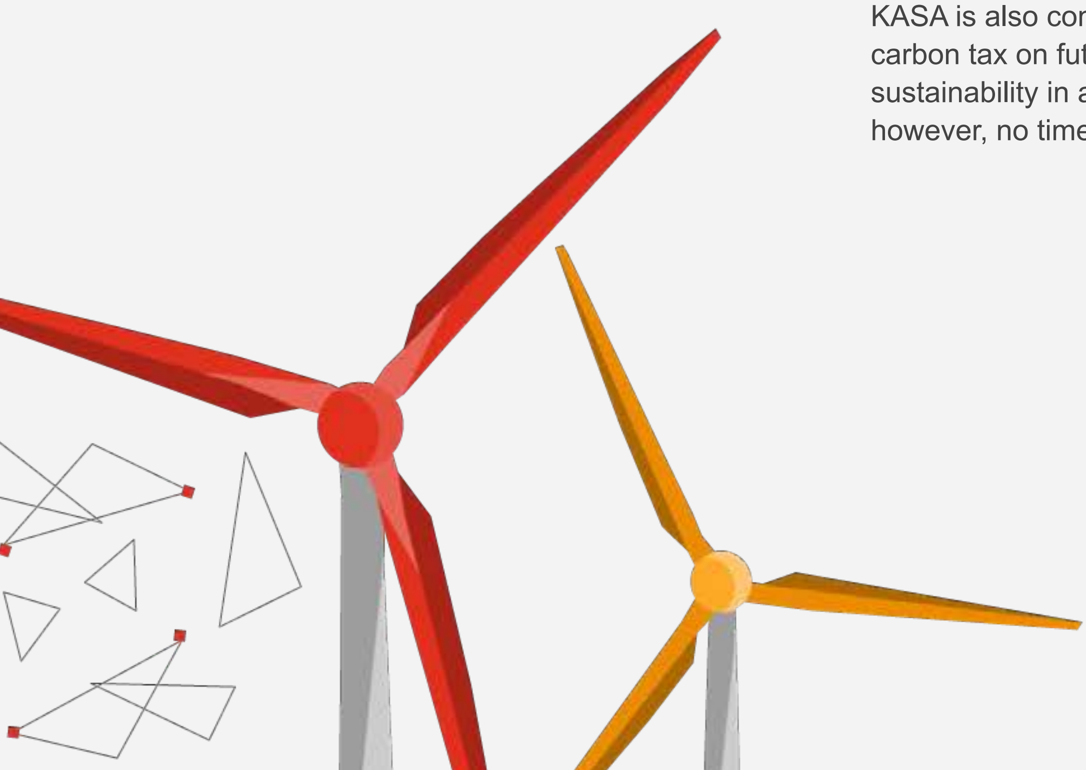
One of our largest trading partners is China. President Xi Jinping made an announcement in September 2020 that China would aim to become "carbon neutral" before 2060, joining other countries like the United Kingdom, Japan, South Korea and Singapore that have pledged to be net zero by 2050.

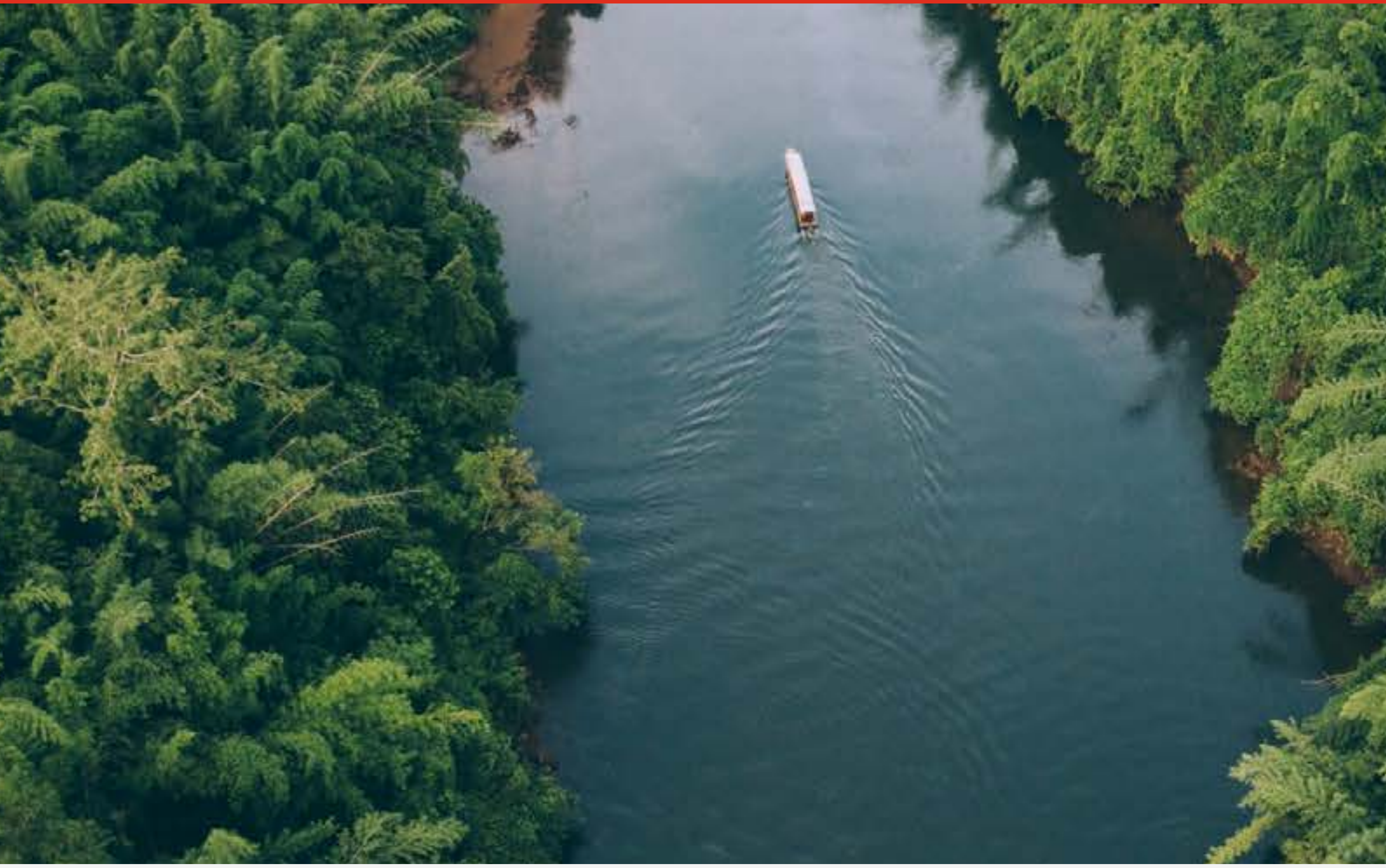
Achieving this goal would mean that China will have to continue to invest heavily in renewable energy technology and have supporting policies to move away from the fossil fuel economy. The question remains whether governments that have declared their net zero ambitions would introduce new measures to reduce carbon footprints in their supply chain. Businesses will need to anticipate this risk.

Pressure to review and enforce environmental laws in Malaysia

The highly disruptive water cuts in the Klang Valley in recent months hastened the government's move to increase supervision and enforcement. In September 2020, the Environment and Water Ministry (KASA) mentioned that it is revising the Environmental Quality Act 1974 to include climate change and sustainability to help reverse the alarming trend of environmental degradation.

KASA is also considering the need to impose carbon tax on future investments related to sustainability in a bid to tackle climate change, however, no timeline has been provided.





Adverse reaction from lack of ESG commitment

Besides being a major producer of timber and wood products, Malaysia is the second-largest producer of palm oil and the world's largest medical glove producer. Our oil palm plantations have come under scrutiny over logging activities, forest-clearing, fires and labour abuses, and at one time faced sanctions from the EU.

Another major export facing increased scrutiny is the glove industry. Malaysia being the world's largest medical glove producer faces the risk of losing the US glove market over labour force issues.

Although Malaysian sustainability laws and regulations are still taking shape here, companies must uphold global ESG practices and put in place frameworks - so that they are not caught unaware by more stringent regulations in their targeted markets.

“

The financial implications of not paying enough attention to environmental and social impacts are becoming more material than before, with regulatory fines approaching billions of dollars, exclusion from international markets, and loss of customer goodwill.

As businesses seek to grow, the need for institutional funding is essential and the tangible costs of ignoring direct and indirect sustainability risks will be very high. A key ingredient for success is board-level buy-in and active accountability towards sustainability.

The debate on the ‘costs’ of sustainability is past us; it is clearer now more than ever that sustainability is a value driver and if not managed well, leads to sizeable and tangible economic losses. Companies who still consider environmental and social impacts separately from profits will find it difficult to survive in the coming decades. This is why boards and shareholders must be accountable towards sustainability risks and make it key to all aspects of the business. ”

Luanne Sieh
Head, Group Sustainability
CIMB Group

4. Fiscal policies

In a 2010 report, PwC stated that “a combination of carrot (tax incentives) and stick (regulation, tax charges) is required to ensure that organisations minimise environmental impact and promote responsible environmental behaviour (Chart 7 below).

10 years later, this remains true. Fiscal policies, whether it is tax or incentives to encourage investing in development priorities and also generate revenues for conserving the environment - is still key towards propelling companies to be sustainable.

Across the world, various countries are rolling out budgets for a greener future.

Economic recovery through sustainability, South Korea

South Korea was among the first countries to incorporate green growth into its fiscal policy. Following the 2008 global economic crisis, the Korean government unveiled one of the world’s most significant green fiscal packages representing 4.5% of its 2008 GDP or worth US$39 billion[3] to stimulate growth and job creation.

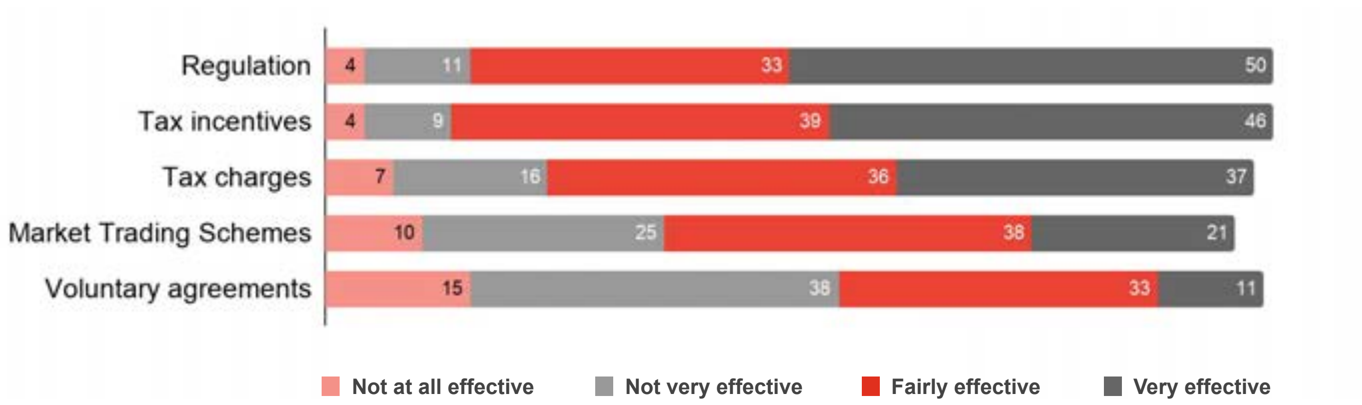
The adoption of the low-carbon, green growth fiscal policy has helped to steer the country’s economic recovery through supporting investments in water and waste management, green transportation, energy efficient buildings, and clean energy. In the aftermath of the global economic crisis, South Korean made a remarkable V-shaped recovery by the second half of 2010, reporting an impressive 6.2% growth in 2010.

Europe's recovery and finance plan

The European Union (EU) has allocated €1.8 trillion to help support the economic recovery and social damage brought about by the COVID-19 pandemic. At least 30% of the budget and recovery fund will be allocated to help achieve the Green Deal, which aims to transform EU from a high- to low-carbon economy.

This could see the EU spending nearly €550 billion on climate protection from 2021 to 2027 and €225 billion could be raised via green bonds through the EU recovery fund.

Chart 7: A combination of carrot (tax incentives) and stick (regulation, tax charges) is required



How effective do you feel each of the following tools are/would be at encouraging your business to reduce its environmental impact? Base: Total (654)

Source: PwC report, Appetite for Change.

[3] The green fiscal package was allocated to nine key projects and 27 supporting projects in water and waste management, green transportation, energy efficient buildings, and clean energy according to the Organisation for Economic Co-operation and Development (OECD)..

Sustainability measures embedded in Malaysia's Budget 2021

Closer to home, Malaysia's Budget 2021 has embedded sustainability and for the first time, the Budget is aligned with the UN SDGs. The Government has provided a comprehensive list of measures in the Budget to support the private sector's sustainable initiatives from funding, adoption of green/climate technology to strengthening of natural resources and biodiversity.

Among the key budget proposals include:

- Continuation of the successful Green Technology Financing Scheme (GTFS), with an allocation of RM2 billion to encourage the private sector to participate in green technology.
- Plans to create a Sustainable Financial Hub, and position Malaysia as a regional hub for a sustainable lifestyle.
- RM600 million worth of funds for forest plantation development and impactful high-value farming projects

Over 150 global corporations, with a combined market capitalisation of over US$2.4 trillion, urged world leaders to build net-zero climate targets into COVID-19 recovery efforts and stimulus packages

The Science Based Targets initiative, the UN Global Compact, and the We Mean Business coalition

Global investors managing a combined US$12 trillion called on EU leaders to deliver a sustainable economic recovery from the COVID-19 pandemic

Institutional Investors Group on Climate Change

5. Customer behaviour

Customers care for the environment

A retail consultant coined the term ‘kindness economy’ nearly 10 years ago, where businesses thrive because they respect people and the environment. This thinking is now mainstream. Signs of reduced air pollution and more vibrant biodiversity during the lockdown may spur on consumers support for sustainability

PwC’s Global Consumer Insights Survey 2020 research revealed a clear embrace of sustainability and a sense of civic duty. For example, 52% of our respondents in Southeast Asia say they expect businesses to be accountable for their environmental impact. 52% of them also say they would avoid the use of plastic whenever possible.

However, sustainability is more of a bonus than a core purchase driver

The Conference Board’s global consumer research shows that shoppers have considered sustainable features to be a bonus than a core purchase driver. For example, environmental impact ranks only fifth among the surveyed consumers’ decision criteria for daily mode of transportation, after speed to destination, cost, convenience, and safety.

In summary

The changes in fiscal and regulation policy, and investors and consumer behaviour as outlined above are already in motion. They will either limit a company’s competitiveness or increase its cost to operate, depending on what companies do now. For some companies, it could also be a fundamental ‘license to operate’ question. If companies adapt well, they can reduce ESG risk, deliver cost savings and even generate new revenue streams.

Most Malaysian companies will have their hands full with recovery efforts post COVID-19. Can they innovate and include sustainability in their core strategy in time for these changes?

To help companies rebuild better from the pandemic, the following chapter looks at how the government, industries and corporates should be getting ready and reimagining their strategies, plans and products to be sustainable.

The protection of the environment remains a long term priority for over half of surveyed companies.

Voice of the Industry: Sustainability Survey 2020

2

Is Malaysia ready to tackle climate change?

2.1. Future proofing the economy

I. Macro impact of climate change

Period of relative climate stability may be coming to an end

Various studies have shown that the effects of global warming are unimaginable, and we can no longer afford to postpone policies to tackle the problem. Chart 8 highlights that August 2020 was about 2.14°C hotter than the average month recorded on Earth since 1880.

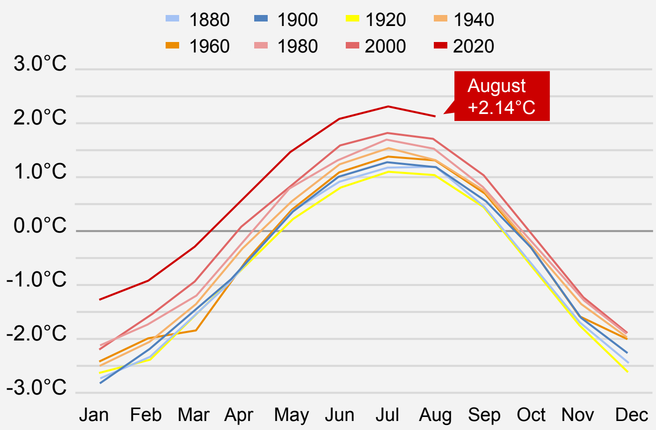
The Intergovernmental Panel on Climate Change (IPCC), a body of the United Nations (UN) dedicated to providing objective and scientific information on climate change, reported that a 2°C average global temperature increase, from pre-industrial level, would exacerbate extreme weather, rising sea levels and diminishing Arctic sea ice, coral bleaching, and loss of ecosystems (see chart 9).

It added that limiting global warming to 1.5°C compared with 2°C would reduce challenging impacts on ecosystems, human health and well-being.

It is clear that the longer we wait, the higher the costs will be. However, pursuing sustainable initiatives is not only about saving the planet. It is just as much about making sure that the country's economy is future proof.

Chart 8: Earth is heating up

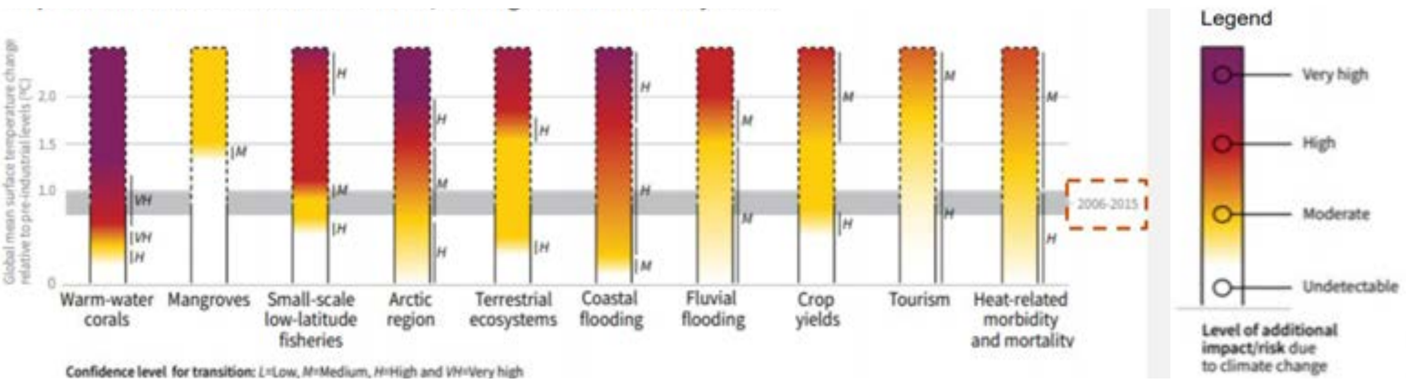
Monthly divergence from average temperature (calculated for 1880-2015) in selected years



Source: Statista

Chart 9: Impact and risks for selected natural, managed and human system

The key elements are presented here as a function of the risk level assessed between 1.5°C and 2.0°C



Source: IPCC (2019) SR15 Summary for Policymakers

Chart 10: Two sides that are driving the sustainability agenda

Climate change risks

77% of people

in Southeast Asia living along the coast or in low lying river deltas will be threatened by rising temperature and sea levels - *Center for Strategic and International Studies*

US$675 billion

annual economic loss from natural disasters in Asia Pacific. 60% are drought-related agricultural losses - *United Nations Economic and Social Commission for Asia and the Pacific*

2.6% loss of GDP

Asia's economy will be 2.6% smaller by 2050 due to lack of climate resilience - *EIU (the Economist Intelligence Unit)*

Climate change opportunities

US$98 trillion

cumulative global GDP gains from transforming the energy system by 2050 - *International Renewable Energy Agency (IRENA)*

US$60 billion

global venture capital investment in climate tech between 2013-19, with a compound annual growth rate of 84% - *PwC The State of Climate Tech 2020*

24 million jobs

could be created globally by 2030 from a shift to a greener economy if the right policies are put in place - *International Labour Organization*

Malaysia is at risk of climate change

Climate change is already adversely impacting economies around the world. Malaysia is also not spared from the impact of climate change. In fact, Malaysia, located near the equator, is at risk of higher temperature rise than the average.

1. In the **agricultural sector,** increasing temperature and the unpredictable droughts and rainfalls could impact crop yields.

   According to the Food and Agriculture Organization of the UN, declines in rice yield can be triggered where temperatures exceed certain thresholds at key stages during the plants development, and a study concluded that rice grain yield declined by ≈15% for each 1°C increase in growing-season mean temperature[4].

   Adverse weather conditions due to rising temperature could lead to more volatile palm oil prices due the changes to palm oil, soybean and any other edible oil production across the world due to changing global weather patterns.

2. **Rising sea levels** from melting glaciers triggered by warmer temperatures have begun eroding Malaysia's shorelines. Sea levels in Malaysian waters have been increasing at an average rate of 3.67 ± 0.15 mm/year, higher than the projected global sea-level rise of 1.7 – 3.1 mm/year[5].

   Coastal areas around Malaysia could gradually face the risk of being submerged. If left unchecked, these areas will not be suitable for agriculture, leading to damage to assets and infrastructures.

3. **Increases in flood incidents** across the country due to the rising number of sudden storms and incessant rain in recent years. Between 1998 and 2018, floods have caused roughly RM5.82 billion in damage, according to IPCC.

   Since, 2010, major floods have occurred in 2010, 2012, 2014 and 2017, with the 2014 northeast monsoon floods being one of the worst in history. It was reported to cost the agriculture sector RM299 million.

[4] Shaobing et al, "Rice yields decline with higher night temperature from global warming", Proceedings of the National Academy of Sciences, 2004.

[5] Tang, Kuok Ho Daniel. "Climate Change in Malaysia: Trends, Contributors, Impacts, Mitigation and Adaptations." Science of the Total Environment, 2019, cited in Khazanah Research Institute, "Climate Crisis: A Persistent Threat to Food Security", 2020

II. Malaysia's path to sustainability

Malaysia's sustainable development journey

Malaysia has taken into account the economic, social and environmental aspects of sustainability in its development plans. It has supported and implemented the 2030 Agenda for Sustainable Development Goals.

This has been incorporated into the strategies and initiatives of the 11th Malaysia Plan (11MP) (2016-2020), which includes actions by Malaysia such as green tech financing, single use plastics policy and the continuous expansion of our MRT network.

Additionally, continued support towards sustainability is to be expected with the 12th Malaysia Plan (12MP) (2020-2025), which will cover the following three development dimensions:

- Economic empowerment
- Environmental sustainability; and
- Social reengineering

Alongside the national plan, the government is committed to reversing the environmental degradation trend. In September 2020, the Environment and Water Ministry (KASA) mentioned that it is revising the Environmental Quality Act 1974 to include climate change and sustainability, and also considering a proposal for a new Climate Change Act and carbon tax on future investments.

Besides that, the government is mulling over other initiatives[6], such as:

- Environmental governance standards
- Renewable energy commitment
- 50% forest cover protection
- Circular economy
- Green financing

These plans, initiatives and commitments are crucial in closing progress gaps towards achieving sustainability.

Chart 11: Malaysia's climate action priorities 2018-2020

Pillar V: Enhancing Environmental Sustainability through Green Growth

Strategy C1: Intensifying Climate Change Mitigation

- Greater use of renewable energy (RE)
- Optimise demand side management (DSM) for energy
- Encourage low-carbon mobility
- Promote construction of green buildings
- Adoption of SCP concept in expanding green market
- Improve waste management

Strategy C2: Augmenting Climate Change Adaptation

- Enhancing adaptation measures

Strategy C3: Strengthening Disaster Risk Management

- Enhancing integration of disaster risk reduction
- Enhancing disaster preparedness
- Increasing capacity in disaster response

Source: 11th Malaysia Plan Mid-Term Review

[6] Source: Dato' Sri Mustapa bin Mohamed, Addressing Climate Change in Malaysia, Climate Week New York, September 2020

Untapped ESG opportunities in Malaysia

Despite the plans and announcements of various climate change initiatives, Malaysia still lags behind other countries when it comes to investing in developments that mitigate climate change.

For example, Malaysia is behind other countries when it come to the penetration of renewable energy, electric vehicle (EV) sales and construction of green buildings. This is worrying as electricity, transport, and construction are among the top greenhouse gases (GHG) emitting sectors in the country.

The lack of investment in climate change will make it harder to offset Malaysia's growing GHG emissions, which have doubled in 20 years (see chart 13).

Similar to COVID-19, the lower income earners, would be adversely affected by the lack of developments in climate change. With limited assets and access to insurance, poor households do not have the capacity to deal with climate related shocks. This could lead to unemployment and greater income inequality. For example, high frequency of floods or drought can result in loss of shelter and income generating activities for the poor, and increase their dependency on humanitarian aid.

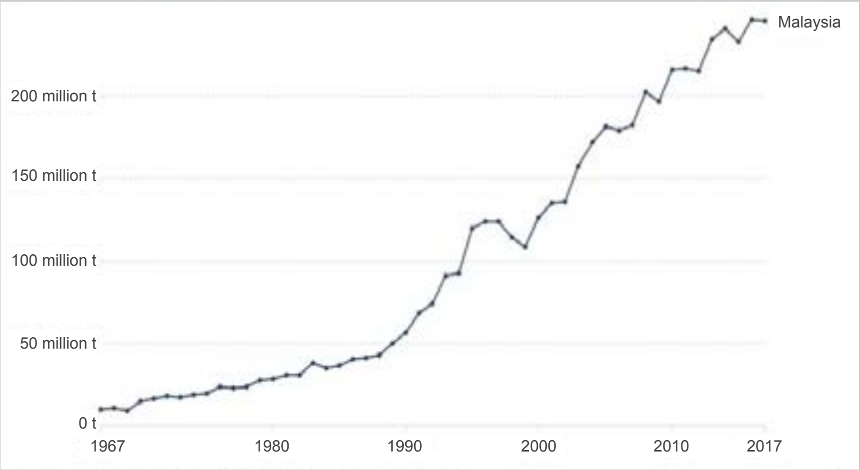
Chart 12: Inroads made in selected climate change developments in Malaysia and comparative countries

	Malaysia	Comparison
Renewable energy penetration	• **6% (2018)** (2025 target: 20%)	• Thailand: **12%** (2019) • Indonesia **9%** (2020) • Global: **28%** (Q1 2020)
Green vehicle sales penetration (EV and hybrid vehicles)	• **2.2% (2019)** **EV:** 32 units (2019), 2 units (2018) **Hybrid:** 13,049 units (2019) 20,744 units (2018)	• UK: **9.9%** (10 months of 2019) • Europe: **7.5%** (Q1 2020)
Certified green buildings	• **< 1% of building stocks (2019)**	• Singapore & London: **40 to 50%** of building stocks (2010)

Source: Various sources

Chart 13: Malaysia annual CO2 emissions

Annual CO2 emissions*, measured in tonnes per year.



Malaysia's CO2 emissions has nearly doubled in 20 years from 1997 to 2017

Source: Our World in Data

* Emission intensity refers to the volume of GHG emissions per unit of GDP

Potential policy measures

Addressing the said sustainability risks will require significant government policy interventions, long term planning and public private sector partnership.

The EU Green Deal case can provide references to Malaysia on potential policy tools and mechanisms that could be adopted.

Chart 14: EU Green Deal, examples of policy tools to transition to a green economy

Pricing, including taxation	Carbon pricing and emissions trading schemes can send pricing signals to emitters to modify their behaviour. Similarly, taxation instruments such as the carbon border tax can ensure success in facilitating clean energy.
Subsidies	Subsidies will remain an important part of the policy toolkit as they correct cost differences between green and brown alternatives e.g. by removing subsidies from fossil fuel and high carbon products, and providing subsidies to greener alternatives.
Infrastructure investments	Governments' vision and support of infrastructure will be crucial given the many interdependencies between the private investment decisions and the availability of infrastructure.
Capital	Total investment for the Green Deal is estimated to be around €360 bil a year over the next decade or roughly 2.3% of the EU's GDP in 2019. Of the total investment amount, around 28% will be funded by the European Green Deal's Investment Plan, and the remaining 72% financed by both the private and public sectors, including through the issuance of green bonds.
Upskilling	Significant investments in upskilling and reskilling of the labour force will be needed for a just transition, to ensure no one is left behind as we decarbonise the economy. While many jobs will be lost in the process, a well managed transition can become a strong driver of job creation, job upgrading, social justice and poverty eradication.
Resources & supply chain	Securing new supply chains is essential in diversifying the sourcing of raw materials for renewable energy in order to increase and sustain the national security energy supply.

Source: Various sources

2.2. Managing industries in transition

I. Industries dependent on nature

Most economic activities rely on nature

All businesses depend on natural capital assets and ecosystem services either directly or through their supply chains. The World Economic Forum in collaboration with PwC recently published a report '*Nature Risk Rising*' that shows US$44 trillion of economic value generation – more than half of the world's total GDP – is moderately or highly dependent on nature and its services, and is therefore exposed to risks from climate change and nature loss.

While the majority, if not all, of economic activities face climate risk, the scale of it would vary from one sector to another. The three largest sectors that are highly dependent on nature generate close to US$8 trillion of gross value added. These are:

- Construction (US$4 trillion);
- Agriculture (US$2.5 trillion); and
- Food and beverages (US$1.4 trillion).

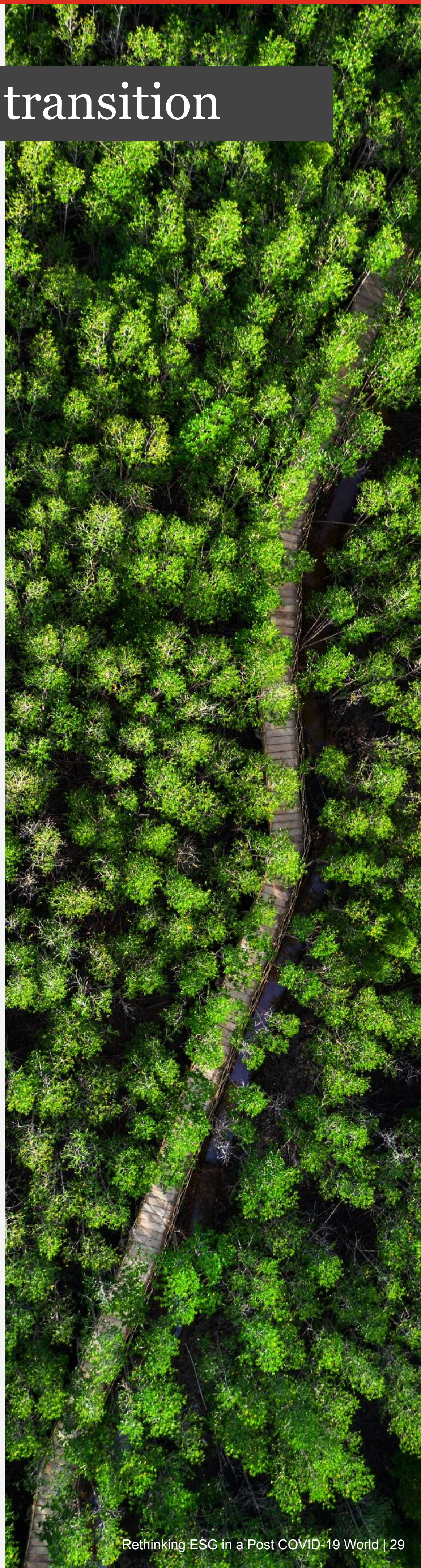
This is roughly 24 times the size of the Malaysian economy. Such sectors rely on either the direct extraction of resources from forests and oceans or the provision of ecosystem services such as healthy soils, clean water, pollination and a stable climate.

Chart 15: Climate related risks

TCFD divided climate-related risks into two major categories: transition risks and physical risks.

Physical risk	If we do not contain climate change, physical risks will materialise. Drought · Floods and higher sea levels · Heat · Extreme weather events · Wind
Transition risk	If we embark on a transition path, transition risks will materialise. An orderly transition is preferred over an abrupt and disorderly transition. Technological innovation · Climate law and regulation · Market

Source: PwC based on TCFD Recommendation (2017)



Significant transition risks ahead for Malaysia

BNM reported that 10.3% of total assets of banks, amounting to around RM287 billion, are potentially exposed to climate change. The sectors that have relatively higher exposures include construction, transport, primary agriculture and utilities. These four sectors account for 84% of the RM287 billion total banking assets potentially exposed to climate risk.

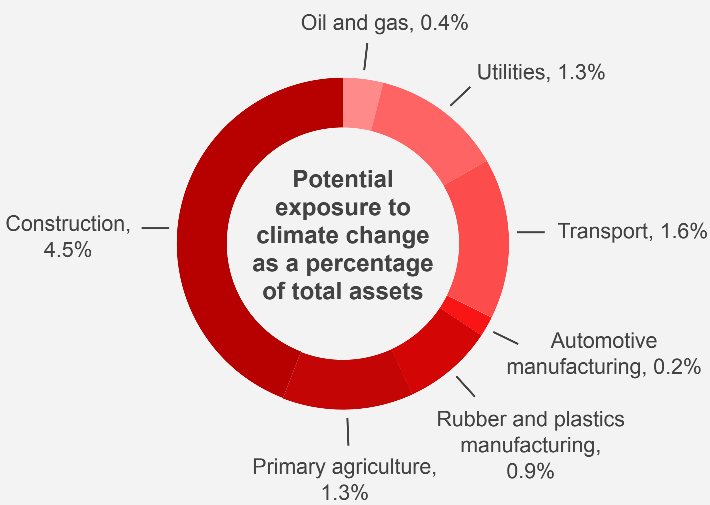
As the world commits to reducing greenhouse emissions, high-emitting sectors would be severely impacted as they face declining demand, big shifts in asset values or higher costs of doing business. In Malaysia, this would include sectors like electricity and heat, transport, and manufacturing and construction.

The journey to a greener future poses immediate transition risks. Chart 12 in page 27 shows that there are gaps between Malaysia and other countries' climate change developments. If not managed well, policy, technology and market changes can affect valuations and companies' bottomline. These adjustments will not come easily, especially for small players.

To avoid sudden and material losses, industries need to anticipate future policy changes, such as plans to revise the Environmental Quality Act, or the publication of the Climate Change and Principle-based Taxonomy by BNM.

Chart 16: Exposures of Malaysian banks to climate change

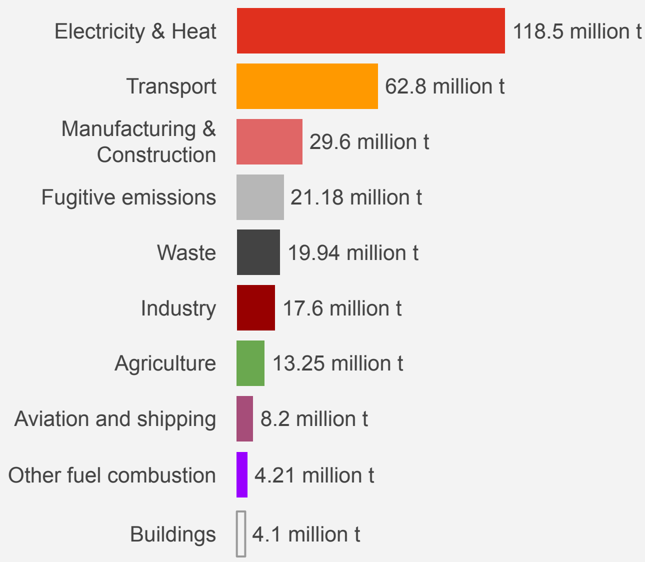
10.3% of total assets of banks, amounting to RM287 billion, are potentially exposed to climate change



Source: BNM, 2020

Chart 17: GHG emissions by sector, Malaysia, 2016

GHG emissions are measured in tonnes of carbon dioxide-equivalents (CO_2e).



Source: Climate Watch - World Resources Institute, 2020 as cited in Our World in Data

Malaysia's export industries subject to sustainability risks

Malaysia, being an open economy, with exports amounting to 64% of GDP in 2019, is subject to foreign countries' ESG policy and consumer perception. Foreign governments could also use ESG regulations to protect their local industry while consumers demand for products and services that comply with sustainability standards.

A significant portion of Malaysia's exports (around 48%) are to developed countries, amounting to around RM473 billion in 2019. These countries are more advanced in ESG adoption and could impose higher ESG standards on their imports in the future.

Malaysia's key exports are already subjected to ESG risks. For example:

- **Palm oil** - Many have expressed concerns about the environmental impact and labour practices of the industry, which accounts for 7% of Malaysia's gross exports. Regardless of whether these concerns are justified, the fact remains that the industry is faced with significant transition risks.
- **Rubber gloves** - There are also concerns about forced labour issues amongst Malaysian glove producers. This could limit our export of the product, estimated to reach RM20 billion in 2020, according to the Malaysian Investment Development Authority.

Malaysian industries that are involved in the global supply chain will need to respond to this by preparing themselves to be sustainability-ready so that they can future proof their footprint globally. Failure to comply may result in their products or services being denied entry into certain markets.

ESG related opportunities

Transition to a low carbon economy would also come with opportunities for industries. From the cost aspect, optimising carbon footprint can lead to resource efficiency and cost savings, especially through the adoption of the circular economy, which focuses on reuse, reassembly, refurbishment and recycling. Aligning with ESG considerations would also develop our industries' adaptive capacity to respond to crisis, for example, by building resilience along the supply chain.

From the business perspective, it can present new market opportunities for investment, innovation, and development of new products and services, with access to new markets. For example:

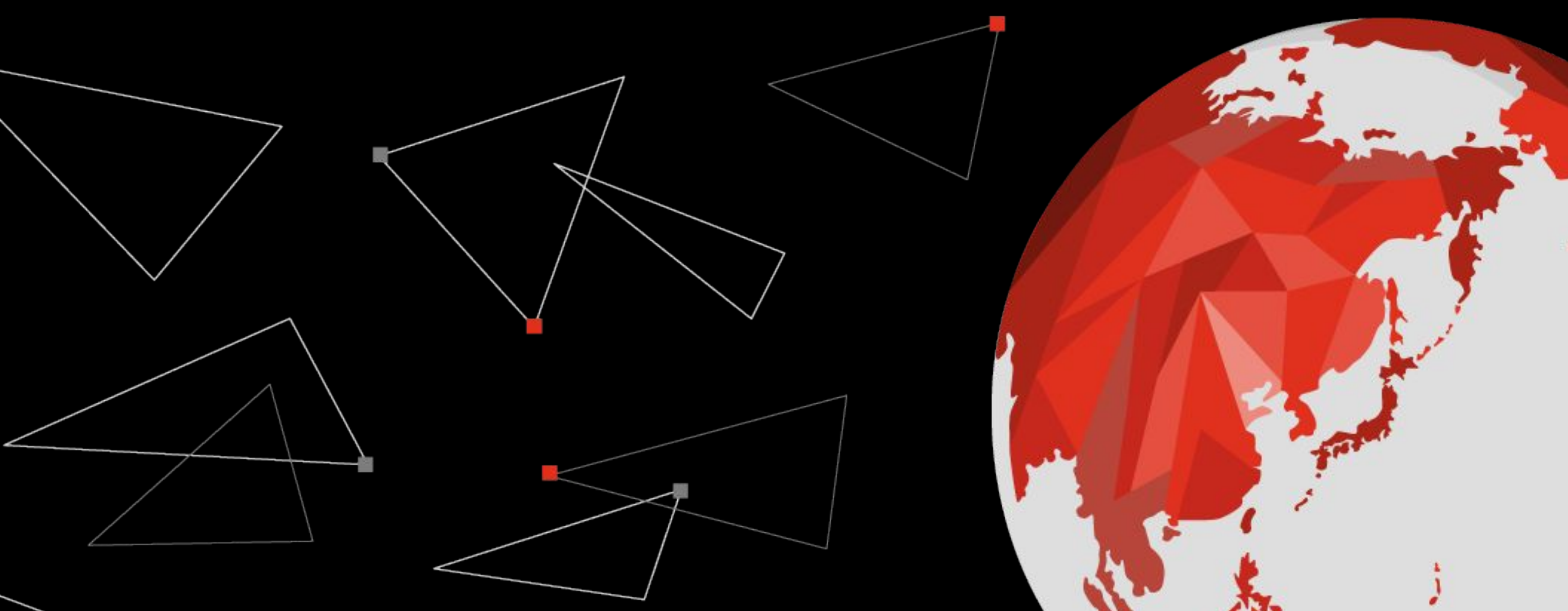
- While there is greater scrutiny on coal and petroleum, clean energy sources like gas and renewables are expected to enjoy bigger growth in demand.
- There are more opportunities at the other end of the spectrum, such as carbon capture solutions.
- These solutions can help realise the country's solar energy potential, given that Malaysia is the third largest solar cell and module manufacturer in the world.
- With the electrical and electronics (E&E) being Malaysia's largest export industry, we could capitalise on the E&E ecosystem to move into the EV industry.

These developments present an array of opportunities for the country.

This shift represents a once in a century opportunity. Global capital is increasingly channeled towards sustainable projects and BNM is encouraging financial industry players to be more proactive in increasing funding pathways for green and sustainability related projects. Malaysian industries should position themselves as champions of ESG - protecting the climate while creating jobs and opportunities and thus increasing the prosperity of the society.

> The global interest on the need for companies to adopt responsible business practices has grown continuously over the years from a wider range of stakeholders.
>
> Apart from the scrutiny around familiar issues such as climate change impacts and the challenges in tackling deforestation, **the recent advent of the COVID-19 pandemic has further increased the focus around the safety and wellbeing of workers in various industries.**
>
> These challenges concern us too. They have driven us to continue to work together with our stakeholders in strengthening the implementation of responsible agriculture practices in our operations, as well as throughout our supply chain in the landscapes we operate in.

Rashyid Redza
Head, Group Sustainability
Sime Darby Plantation Berhad



2.3. Evolving corporate landscape

Corporate sustainability, form over substance

Companies do not often place sustainability as a core element in their business strategy. Many perceive that the costs outweigh the benefits.

This is reflected in the latest PwC's SDG Reporting Challenge, where over 700 companies globally were analysed on corporate and sustainable reporting. While half of the companies we studied had clearly prioritised the SDGs in their public statements, only 25% had integrated those SDGs into their business strategy.

In the recent 23rd PwC Annual Global CEO Survey, climate change does not appear among the top ten threats to CEO's growth prospects, despite environmental concerns being identified as the top global risks in the World Economic Forum's (WEF) Global Risks Report 2020.

Malaysia's corporate performance may be no different. According to Refinitiv's Environmental Pillar released in November 2019, Malaysia's largest companies were ranked the third lowest in the region, scoring 57.82. This falls below the Asian regional average score of 62.34.

These indications may point to underlying skepticism among businesses about the material implications of climate change and the benefits of climate actions. However, can businesses afford to be shortsighted when it comes to climate change?

Global

72% of companies mentioned the SDGs in their reporting

25% of companies included the SDGs in their published business strategy

14% of companies mentioned specific SDG targets

Malaysia

73% of companies mentioned the SDGs in their reporting

20% of companies included the SDGs in their published business strategy

11% of companies mentioned specific SDG targets

Source: PwC SDG Challenge 2019

For good corporate governance standards, the majority of boards ideally should be independent voices. Very often these voices are not sufficiently aware of risks arising from the climate crisis. **Climate change is a financial risk, it's not just a humanity or equity problem. It's going to impact bankruptcies, your retirement, mortgage insurance capabilities and your life, very soon.**

We can’t have a successful business on a dead planet. Environmental sustainability and commercial sustainability are one and the same thing. This transition is one of the most significant transformations in economic history and it is very likely that the asset class of net zero assets is going to become very significant. There are a lot of opportunities for business as we transition from brown to green. Companies that are prepared and boards that are observant will be able to tap into this.

Datin Seri Sunita Rajakumar
Founding Chairperson
Climate Governance Initiative Malaysia

Adapting to ESG challenges

This year, **environmental-related concerns have emerged as the top five risks** that respondents believe are most likely to happen in WEF Global Risk Report 2020. This is attributed to the rise in global temperatures that is projected to rise by at least 3°C by 2100, doubly exceeding the 1.5°C limit experts say could deter devastating consequences on world economies, societies and the environment.

Environmental problems also accelerate existing social issues, and vice-versa. Adverse changes to the environment often have an outsized impact on the more vulnerable and those in the lower income groups, exacerbating the existing inequalities. Displacement and increased migration caused by environmental problems would place additional pressures in the society, again impacting some socio-economic groups more than others.

In PwC SDG Challenge 2019 Report, nearly two thirds of companies surveyed have attempted to identify SDG goals most relevant to their business. Besides Climate Action (SDG13), goals that are most mentioned by corporates include:

- Decent Work and Economic Growth (SDG8)
- Responsible Consumption and Production (SDG12)

While it is encouraging to see companies have started to identify Climate Action (SDG13) goals as relevant to their businesses, there is **more work that can be done by businesses in adding sustainable value to society**. Many companies still have yet to identify goals such as Zero Hunger (SDG2), Life Below Water (SDG14), and No Poverty (SDG1) to be relevant to their business.

It is imperative for corporates to understand that environmental and social issues are deeply interlinked and true social improvement cannot happen as long as environmental problems persist, and vice versa. Addressing these concerns are crucial for a thriving business. We cannot just follow one and ignore the others.

Charts 18: Specific SDGs most and least mentioned by corporates

Most mentioned SDGs	Least mentioned SDGs
Decent Work and Economic Growth	Zero Hunger (SDG2)
Climate Action	Life Below Water
Responsible Consumption and Production	No Poverty

Source: PwC SDG Challenge 2019

Rebuilding corporate resilience through sustainability

The time has come to form stronger resilience in addressing climate change and future proofing businesses from catastrophic impacts that are unfolding. Corporate leaders have a crucial role in driving the sustainability agenda forward.

In integrating climate related risk into business strategies, BNM in its Climate Change and Principle-based Taxonomy Discussion Paper, highlighted three areas of focus:

- Stronger governance on climate change
- Greater knowledge and integration of climate risk into management, and
- Disclosure of such risks via the TCFD

These steps are aligned with WEF and PwC's published set of eight principles for effective climate governance, designed to help companies practically assess and debate their organisation's approach to climate governance and frame their thinking about how to make this approach more robust. The principles include:

- Climate accountability
- Subject command
- Materiality assessment
- Reporting and disclosure

Whilst these actions listed are more focused on climate action, good governance should be embedded in achieving sustainability overall, rather than just climate risk mitigation.

Chart 19: Guiding principles for effective climate governance on corporate boards

Source: WEF and PwC 'How to Set Up Effective Climate Governance on Corporate Boards', 2019

What does it mean for boards

We have highlighted in the section on investor expectation on page 16, that boards have a critical role to play in sustainability as provided by MCCG.

With companies assessing the impact of climate change and transitioning themselves towards a low carbon future, boards need to be asking questions and putting measures in place to ensure that action is being taken to understand and respond to climate-related risks and opportunities.

From a risk management perspective, do boards have a clear picture of their business exposure to climate risk? This doesn't just relate to the threat of flooding, drought and damage to assets. In fact, the biggest immediate risk for many businesses is the reduction in value of high-carbon assets, even resulting in stranded assets as well as changes to the cost of their supply chain.

From a strategic planning perspective, do boards have a strategy or governance structures in place to deal with the transition? Board members play a crucial role in embedding a company's sustainability agenda into its long term strategy.

On the questions boards should be asking to move their organisation sustainability agenda, please refer to the Appendix for more information.

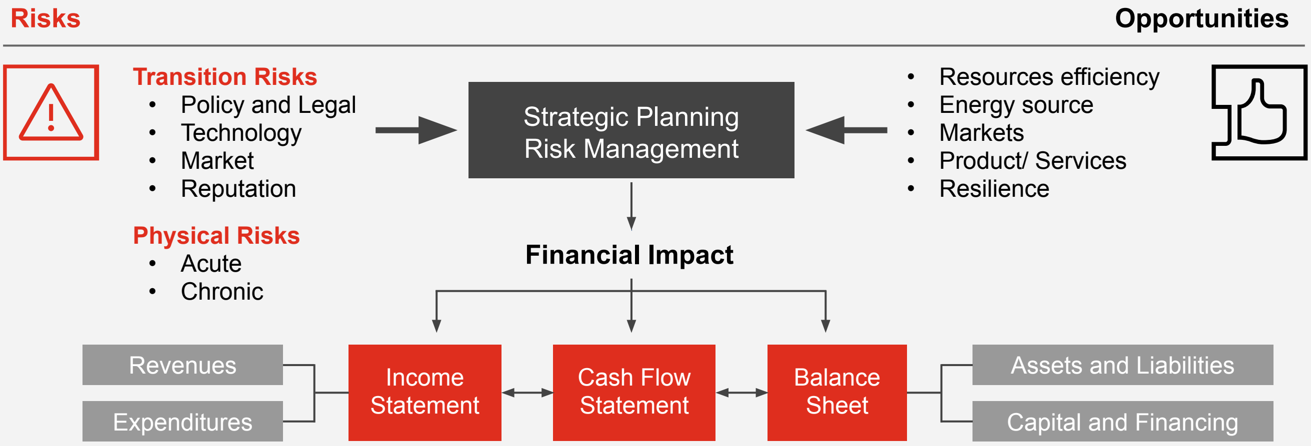
Once sustainability reaches the board level, it needs to form a core part of the company's strategy as it will have a financial impact, from the income statement to the balance sheet. Boards will need to work with management to build the resilience of their business and tap into an array of opportunities in this changed reality.

Due to the complexity of climate change related issues and special knowledge required, boards may want to have a dedicated sustainability committee or an external advisory panel to look into this. Boards should also establish clear Terms of Reference on ESG, outlining the roles and responsibilities of the board when it comes to sustainability.

The heightened relationship between climate risk and financial wealth means that, like any material financial risk, a passive approach to climate governance may be inadequate in satisfying directors' duties of due care and diligence. Boards must actively engage with how climate change impacts their operations, risk and strategy.

Failure to act on and disclose relevant risks or threats may expose them or their companies to legal action. **Courts are increasingly asked to adjudicate on issues relating to climate change.** Citizens and organisations have filed more than 1,300 lawsuits related to climate change in at least 28 countries around the world since 1990[7].

Charts 20: Climate-related risks and opportunities produce tangible financial effects



Source: TCFD Recommendations (2017)

[7] Source: J. Setzer and R. Byrnes. Global Trends in Climate Change Litigation: 2019 Snapshot (LSE, 2019), quoted in Nature

PwC's Net Zero Commitment

Recognising climate change as one of the most pressing problems facing our world today, PwC across our global network, is determined to make a change by committing to a worldwide science-based target to reach net zero greenhouse gas emissions by 2030.

To accomplish this science-based commitment, PwC highlights this in the following three ways:

Operations

- Reduce total greenhouse gas emissions by 50% in absolute terms
- Switch to 100% renewable electricity in all territories where PwC operates
- Improve energy efficiency in offices
- Neutralise our remaining climate impact by investing in carbon removal projects

Clients

- Embed implications of climate change and ESG into our client engagements
- Advance non-financial reporting so that stakeholders understand implications of business activities on the climate

Policy and advocacy

- Support global efforts to develop transparent and robust ESG reporting frameworks and standards, for instance, through work with the WEF International Business Council, and the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)
- Provide practical guidance to help companies move from net zero pledges to wholescale business transformation.

> A net zero world is within reach. Getting there will take innovation, hard work, collaboration and bold thinking but the benefits will be immense. The business community has a responsibility to act and we are determined to play our part, not just in our own operations and supply chain, but also in the way we advise and support our clients to create a sustainable world for future generations.

Bob Moritz,
Global Chairman of the PwC network

> We have been on the sustainability journey for more than a decade in PwC Malaysia. With our recently announced global commitment to achieve net zero greenhouse gas emissions by 2030, we are determined to play our part in achieving this aspiration. We started energy efficient improvement efforts in our offices in 2019, and have been offsetting emissions associated with business travel. We will continue to enhance our efforts to decarbonise our operations, engage our value chain, support our clients and play an integral role in policy advocacy to drive the transition to a low carbon economy.

Pauline Ho,
Net Zero Lead Partner,
PwC Malaysia

Read about PwC Malaysia's Sustainability efforts in our Annual Report.

Start taking action before others take it for you

Corporates are at risk of losing control of their sustainability narratives. Growing numbers of investors are not merely saying they want better ESG data from companies, they are also investing in data infrastructure to find it.

In the CFA Institute's Environmental, Social, and Governance (ESG) Survey Report 2017, investors' top sources of ESG information on companies were public information and third-party research - not communications or filings from the companies themselves. Passive investment managers, for example, typically rely on large ESG datasets from third-party sources to adjust the weighting of their portfolios.

Much of this third-party information is unverified. It may therefore be inaccurate, but without better corporate involvement, no one can be certain. Given the complexity of how sustainability and climate datasets come together, it is hard for investors to fully trust the available information.

What is certain is that, by leaving a communications gap for third parties to fill, corporates are losing control over their sustainability story. Hence, corporates should ensure that material ESG risks, opportunities, strategic decisions are consistently and transparently disclosed to all stakeholders. Such disclosures should be made in financial filings, such as annual reports and accounts, and be subject to the same disclosure governance as financial reporting.

Call to action

There is an immediate need for companies to move from ambition to action and take a pragmatic approach to transformation. Here are some ways companies can start:

1. Identify the risks that your organisation faces as well as the potential opportunities. Form a view on the risks that your business faces in the near and long term as well as the potential solutions (i.e. opportunities) your business can bring.

2. Identify your key stakeholders (e.g. investors, customers) and their concerns. As public and regulatory pressures increase, it is imperative to form a proper understanding of stakeholder expectations to ensure you are not caught off-guard. Decide which ESG frameworks to leverage after engaging with stakeholders on their expectations.

3. Determine what is most material to you so that you are able to prioritise key issues to focus on. Tackling the issues that have the most impact to you or where you can make the most impact, enables a more effective response.

4. Build strong governance that ensures ESG accountability is driven throughout the organisation, starting from the top. Frameworks should be in place to enable decision making that considers ESG concerns.

5. Develop an action plan to address these issues and communicate them with your stakeholders. By doing so, you are able to manage the expectations of your stakeholders, facilitate implementation and maintain accountability.

Contacts

Dato' Mohammad Faiz Azmi
Executive Chairman, PwC Malaysia

mohammad.faiz.azmi@pwc.com

Soo Hoo Khoon Yean
Managing Partner, PwC Malaysia

khoon.yean.soo.hoo@pwc.com

Nurul A'in Abdul Latif
Markets Leader, PwC Malaysia

nurul.ain.abdul.latif@pwc.com

Meet our Sustainability and Climate Change Team

Andrew Chan
Sustainability & Climate Change Leader

andrew.wk.chan@pwc.com

Azizan Zakaria
Energy & Agriculture

azizan.zakaria@pwc.com

Elaine Ng
Financial Services

yee.ling.ng@pwc.com

Pauline Ho
Net Zero Lead Partner

pauline.ho@pwc.com

Redha Shukor
Sustainable Value Chains

redha.shukor@pwc.com

Herbert Chua
Reporting and Assurance

herbert.gh.chua@pwc.com

Jay Moorthy
Valuation and Impact Measurement

jayaram.krishna.moorthy@pwc.com

Nik Shahrizal Sulaiman
ESG / Shariah, Internal Audit

nik.shahrizal.sulaiman@pwc.com

Taariq Murad
Fiscal Incentives

taariq.murad@pwc.com

How we can help

PwC Malaysia's **Sustainability and Climate Change** practice can help you understand which areas pose the greatest risks to your business, form strategies to address them, and support you through the necessary organisational changes and reporting processes. We can work with you to address your issues surrounding climate change, responsible investment, sustainable finance and sustainable value chains.

Visit www.pwc.com/my/sustainability

Appendix

Questions boards can ask management to understand where your company stands - in terms of ESG commitments and how to chart a path forward:

1. **Are ESG risks included in our Enterprise Risk Management (ERM) programme?** What are the key ESG risks faced by the business? How are we addressing them? How do they evolve under different time horizons?

2. **Is ESG being crafted into our long-term strategy?** How are we looking at ESG to innovate and effectively add value or cost savings to our business? Are ESG risks dealt with separately, or are they fully included in our overall strategy? Are we keeping an eye on what our competitors are doing?

3. **When investors want to talk about our long term sustainable value, should we ask the sustainability or corporate responsibility team to step in?** If our corporate responsibility leader or sustainability officer has oversight of our ESG efforts, is that team working closely with finance, investor relations and risk management? Are members of those teams fully versed in our ESG efforts? Or is it a siloed effort?

4. **Do we have the information we need to oversee our ESG strategies and risks?** Is the board getting the right metrics to monitor these risks effectively?

5. **Have we considered using a framework to assess/report ESG metrics at our company?** Have we taken a look at the Sustainability Accounting Standards Board (SASB) framework, or other available models?

6. **Can we improve the transparency of our ESG disclosures considering investors' expectations?** How can we improve our ESG disclosures and increase trust in this area? How do we benchmark ourselves against other businesses?

7. **Are we effectively telling our ESG story to investors?** Have we included the key ESG-related risks and opportunities in our broader shareholder disclosures, rather than merely including them in a separate report? Have we clearly conveyed to investors how ESG is part of our company's strategy? Are directors who are meeting with shareholders prepared to answer these questions?

Source: PwC, ESG in the boardroom: What directors need to know, 2020