

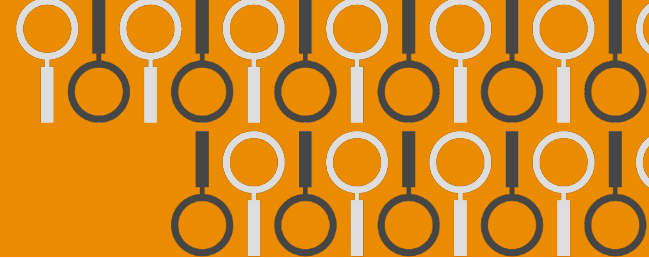
Risk and Regulatory Outlook 2022

Taxonomies for sustainable
finance in Southeast Asia

March 2022



Background and relevance



Overview

The 26th Session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP26) re-emphasised the need for transition to a more sustainable economy, with sustainable finance being an important driver in supporting this transition towards a sustainable future. While these transition efforts may be challenging in the near term, organisations are encouraged to start making changes as requirements continue to develop globally. A third of CEOs surveyed as part of PwC's 25th Annual Global CEO survey¹ were "very concerned" or "extremely concerned" about climate change negatively impacting their organisation over the next 12 months, which illustrates the magnitude of the challenge lying ahead.

COP26 also placed a focus on the financial sector and its responsibility and leadership in mobilising capital for the transition towards net-zero. The UN-convened Net-Zero Banking Alliance (NZBA) constitutes more than 90 banks with a collective US\$ 66 trillion in assets, representing 43% of banking assets worldwide, and aims to expedite the transition towards a sustainable global economy. In addition, 450 financial institutions representing US\$ 130 trillion in assets under management committed to net zero under the Glasgow Financial Alliance for Net Zero (GFANZ).²

¹ PwC, "PwC's 25th Annual Global CEO Survey", 2025

² United Nations Environment Programme Finance Initiative, "Net-Zero Banking Alliance at COP 26", 2021

Taxonomies help translate objectives and commitments into actions and capital flows

To support this transition towards sustainable economies, taxonomies of sustainability- and transition-related economic activities are useful tools that define criteria and approaches for real economies, as well as the financial industry's contribution to sustainability objectives.

Taxonomies for sustainable finance are classification systems which detail sets of criteria that provide a basis for assessing whether and to what extent an economic activity contributes to sustainability objectives, e.g. by providing investors and lenders with market-wide standards to identify sustainable activities. They can include how to classify what sectors/ business activities are considered to be ESG-related; as well as activities that support the transition to lower carbon economies. These taxonomies are typically regulations or standards issued by national government bodies or supranational organisations. Over the past years, taxonomies have been introduced across the world with China (early version of a taxonomy in 2015), the European Union (adoption in 2020 after several years in the making) and Malaysia (adoption in 2021) among the front runners. Furthermore, new taxonomies are being developed by various regulators and entities.

This publication provides an overview of discussions and developments around taxonomies in Southeast Asia and shares insights and best practices on strategic opportunities, operational impact and implementation challenges for financial institutions.

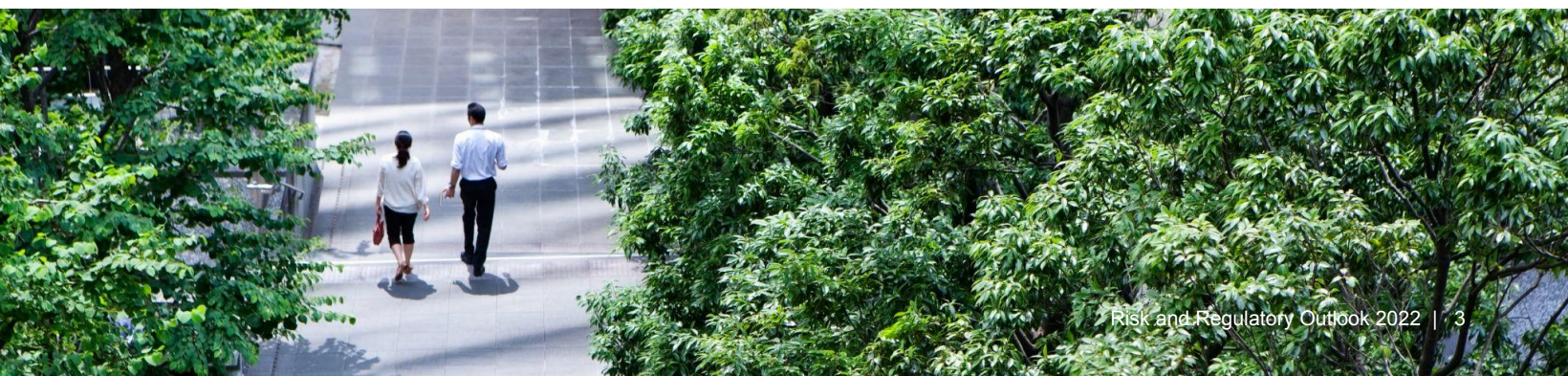




Purpose of taxonomies

Taxonomies serve different stakeholders and can be an anchor of environmental regulation and transformation. The following figure illustrates the fundamental impact of taxonomies on different parties (non-exhaustive).

Figure 1: Impact of taxonomies on different parties (non-exhaustive)



Taxonomies in South East Asia: Steering capital to more sustainable ways of doing business



ASEAN Taxonomy

In November 2021, when COP26 illustrated the importance of the world’s transition, the ASEAN Taxonomy Board (ATB) released the ASEAN Taxonomy for Sustainable Finance (ASEAN Taxonomy) – Version 1.³ The ASEAN Taxonomy signifies a collective effort of the ASEAN Member States (AMS) in transitioning towards a sustainable region with an initial focus on environmental objectives, following the 2030 Agenda for Sustainable Development in Asia and the Pacific. The document can serve as blueprint for member states’ national regulations on sustainable finance.

Version 1 of the ASEAN Taxonomy focuses on climate change mitigation as the primary environmental objective, defines an initial set of criteria and contains a consultative draft on more granular criteria in future versions of the ASEAN Taxonomy. The proposals include but are not limited to:

- extending the taxonomy to more sectors based on additional environmental objectives; and
- incorporating other environmental objectives into the classification approach, to further develop the ASEAN Taxonomy.

Version 2 will also incorporate the feedback received during the consultations following the issuance of Version 1.

Figure 2: Current and future focus areas of the ASEAN Taxonomy

Version	Environmental Objectives & Essential Criteria	Classification System
Version 1 (Current Version)	Environmental Objective #1 (EO1): Climate Change Mitigation	Foundation Framework (FF) Qualitative industry-agnostic assessment: <u>Green - FF</u> Meets one or more of the environmental objectives and does no significant harm <u>Amber FF</u> Meets one or more of the climate and environmental principles, but causing harm. Nevertheless, making efforts to remediate <u>Red - FF</u> Causing harm and no efforts to remediate
	Essential Criterion #1 (EC1): Do no significant harm	
	EC2: Remedial efforts to transition	
Planned in subsequent versions	EO2: Climate change adaptation	Plus Standard (PS) Sector-specific technical screening criteria and thresholds
	EO3: Protection of healthy ecosystem and biodiversity	
	EO4: Promotion of resource resilience and transition to circular economy	

³ ASEAN Sectoral Bodies, "ASEAN Taxonomy for Sustainable Finance - Version 1", 2021

ASEAN Taxonomy (cont'd)

Version 1 highlights five high-level principles to cater to different stages of ASEAN economies, financial systems, and transition paths. Recognising challenges arising from the economic and environmental diversity across the region, the ASEAN Taxonomy adopts a multi-tiered approach; labeled as 'Foundation Framework' (FF) and a 'Plus Standard' (PS).

The Foundation Framework (FF) comprises a sector-agnostic decision tree to guide users in classifying economic activities. The decision tree is based on climate change mitigation as the main objective in Version 1, and will be expanded to the other objectives in subsequent versions.

The Plus Standard (PS) is subject to the current consultation process. The proposed scope comprises activity-level technical screening criteria for activities within the identified focus sectors and enabling sectors in achieving climate change mitigation in Version 1. A stacked approach is proposed in developing the activity-level thresholds to cater for different starting points of entities across ASEAN. The stacked approach allows for higher emissions for a limited period, while incentivising progression to lower emissions.

Figure 3: Proposals for the introduction of the Plus Standard

Focus Sectors

1. Agriculture, forestry, and fishing
2. Manufacturing
3. Electricity, gas, steam, and air conditioning supply
4. Transportation and storage
5. Construction & Real estate activities
6. Water supply; sewerage, waste management and remediation activities

Enabling Sectors (others will be included in the next phase of Taxonomy development)

1. Information and communication
2. Professional, scientific and technical activities
3. Carbon capture, utilisation and storage

Proposed stacked approach (three tiers of threshold)

Tier 3 (Entry)

- This threshold is less stringent and determined by agreed metrics. This tier is static and will be retired at an established point in time, after which this tier would no longer be used to consider taxonomy eligibility.

Tier 2 (Intermediate)

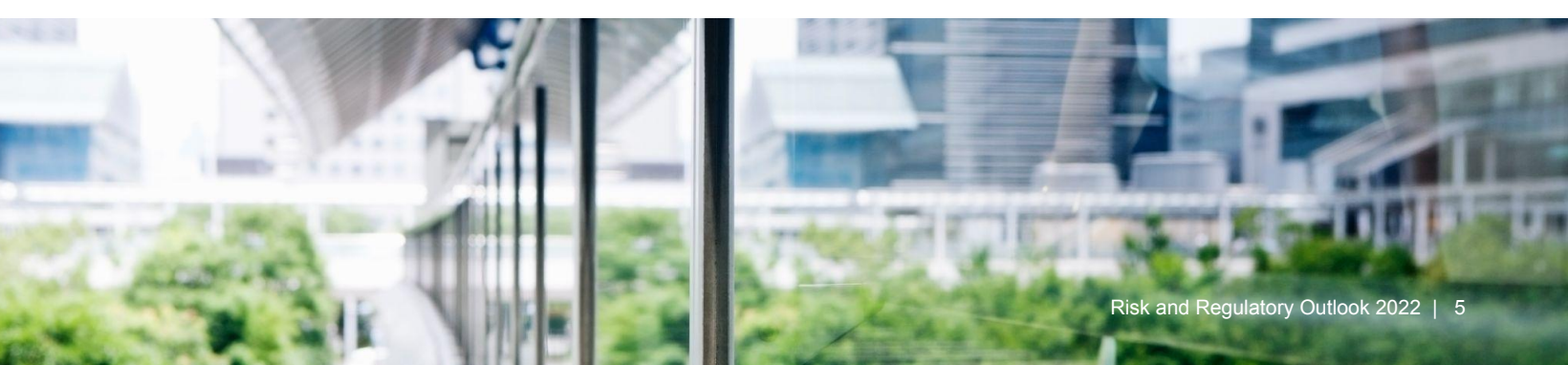
- This threshold is more stringent than Tier 3 but still higher than the most ambitious threshold.

Tier 1 (Advanced)

- Most ambitious threshold and would align with other major international taxonomies. Tier 3 threshold will decline to zero over time.

Classification system

- Green - PS: To be developed
- Amber - PS: To be developed
- Red - PS: To be developed





Malaysia Taxonomy (Bank Negara Malaysia)

On 30 April 2021, the Bank Negara Malaysia (BNM) issued the finalised Climate Change and Principle-based Taxonomy (CCPT)⁴, the first finalised taxonomy in Southeast Asia, after public and industry consultation. CCPT introduces five guiding principles and a standardised classification:

The five guiding principles are

- (1) Climate change mitigation,
- (2) Climate change adaptation,
- (3) No significant harm to the environment,
- (4) Remedial measures to transition, and
- (5) Prohibited activities.

These guiding principles are mapped to climate objectives. CCPT also advised that in applying the taxonomy, key elements of these guiding principles should be embedded in the due diligence assessments of existing and prospective customers. CCPT also sets out five different levels of classification across three broad categories (i.e. Climate supporting, Transitioning and Watchlist).

Additionally, the CCPT proposed that financial institutions could leverage on third party verifications or recognised certifications to inform their internal due diligence process on whether clients meet environmental objectives.

The Malaysia taxonomy is principle-based rather than defining technical screening criteria. Although the paper refers to relevant industries and industry standards as examples, it does not stipulate a focus on a predefined set of industries and sectors. Classifications under the taxonomy are industry-agnostic and derived from a principle-based decision tree.



Singapore Taxonomy (Monetary Authority of Singapore)

In January 2021, the Green Finance Industry Taskforce (GFIT), an industry-led initiative convened by the Monetary Authority of Singapore (MAS)⁵, issued a proposed taxonomy for Singapore-based financial institutions to develop a consistent classification of green activities and transitioning activities. The public consultation ended on 11 March 2021. The draft taxonomy aims to set out an approach developed for Singapore and other ASEAN economies.

The taxonomy pursues four environmental objectives:

- (1) Climate change mitigation;
- (2) Climate change adaptation;
- (3) Protect biodiversity; and
- (4) Promote resource resilience.

A “Do No Significant Harm (DNSH)” principle stipulates that activities aligned with the taxonomies should cause no significant harm to the aforementioned environmental objectives, on communities' social and economic well-being, as well as local laws.

The consultative paper also proposes a “traffic light system” in the first phase. Activities aligned with environmental objectives are categorised as green, transitional activities as “amber”, and activities that are not aligned with the objectives are “red”. The draft indicates that more granular criteria and a timeline for transition would be developed in subsequent phases.

⁴ Bank Negara Malaysia, “Climate Change and Principle-based Taxonomy”, 2021

⁵ Monetary Authority of Singapore, “Industry taskforce proposes taxonomy and launches environmental risk management handbook to support green finance”, 2021





Indonesia Taxonomy

On 20 January 2022, the Financial Services Authority (Otoritas Jasa Keuangan) published the Indonesia Green Taxonomy Edition 1.0 - 2022⁶ as part of the country's efforts to further expedite the development of sustainable finance.

The Indonesia Green Taxonomy Edition 1.0 shall be used as

- (1) a basis for the development of incentive and disincentive policies, and
- (2) guidelines for reporting disclosure, risk management and development of sustainable financial products and/or services.

The current version of the Green taxonomy pursues two environmental objectives:

- (1) climate change mitigation
- (2) climate change adaptation

The Green Taxonomy is developed based on the Indonesia Standard Industrial Classification (KBLI), and mapped 919 sub-sectors of which only 15 are currently classified as eligible in Edition 1.0. The remaining 904 have prerequisites yet to be met to be classified as taxonomy-eligible.

In subsequent versions, OJK aims to extend the coverage to 2,733 sectors.

For the purpose of classifying activities, the Taxonomy sets out the following criteria:

Classification	Description
Green	<ul style="list-style-type: none"> • Do no significant harm • Apply minimum safeguards • Provide positive impact to the environment; <u>and</u> • Align with the environmental objective of the taxonomy
Yellow	<ul style="list-style-type: none"> • Do no significant harm
Red	<ul style="list-style-type: none"> • Harmful activities

⁶ Otoritas Jasa Keuangan, "Indonesia Green Taxonomy Edition 1.0 - 2022", 2022

⁷ Bank of Thailand, "Joint Statement Sustainable Finance Initiatives for Thailand", 2021

⁸ Philippines' Department of Finance, "The Philippine Sustainable Finance Roadmap", 2021



Thailand (Central Bank of Thailand)

On 18 August 2021, the Bank of Thailand (BOT), together with the Fiscal Policy Office, the Securities and Exchange Commission, the Office of Insurance Commission, and the Stock Exchange of Thailand, jointly published the Sustainable Finance Initiatives for Thailand⁷ to accelerate sustainable finance across the financial sector. One of the strategic initiatives aim at developing a taxonomy.



Philippines (Bangko Sentral ng Pilipinas)

In October 2021, the Bangko Sentral ng Pilipinas (BSP) published a sustainable finance roadmap⁸ that "sets out a comprehensive approach that will serve as the foundation for effective strategies to facilitate the mainstreaming of sustainable finance in the Philippines".

The roadmap provides a single definition of sustainable finance and includes the creation of a principle-based taxonomy with guidance notes detailing a non-exhaustive list of positive and negative examples.



EU Taxonomy

In June 2020, the EU Parliament and Council adopted the EU Taxonomy Regulation⁹ that forms the basis for other sustainability-related regulations such as the Corporate Sustainability Reporting Directive (CSRD) with a focus on company disclosures, the Sustainable Finance Disclosure Regulation (SFDR) concerning investment products, and the upcoming Green Asset Ratio (GAR) on the taxonomy alignment of banks' lending activities.

The regulation sets forth a multi-tiered approach to determine if an economic activity is taxonomy aligned:

1. Economic activity makes a substantial contribution to one of the six environmental objectives;
2. Economic activity does no significant harm (DNSH) to the other five; and
3. Economic activity complies with minimum safeguards

The technical screening criteria for each of the objectives are set out in detail in Delegated Acts. So far, detailed criteria and thresholds for the first two objectives "climate change mitigation" and "climate change adaptation" have been issued for material economic activities. A separate dedicated Delegated Act details the disclosure requirements and the timeline of taxonomy-related reporting for non-financial and financial undertakings.

The EU taxonomy and developments around it are important for the Southeast Asia region to keep an eye on, as it is likely to influence regional initiatives. Furthermore, Taxonomy Regulation may be applicable to EU activities of Southeast Asian firms and vice versa. For instance, European investors may use EU taxonomy criteria to assess investments in Southeast Asian assets.

⁹ Official Journal of the European Union, "[Regulation \(EU\) 2020/852](#)", 2020

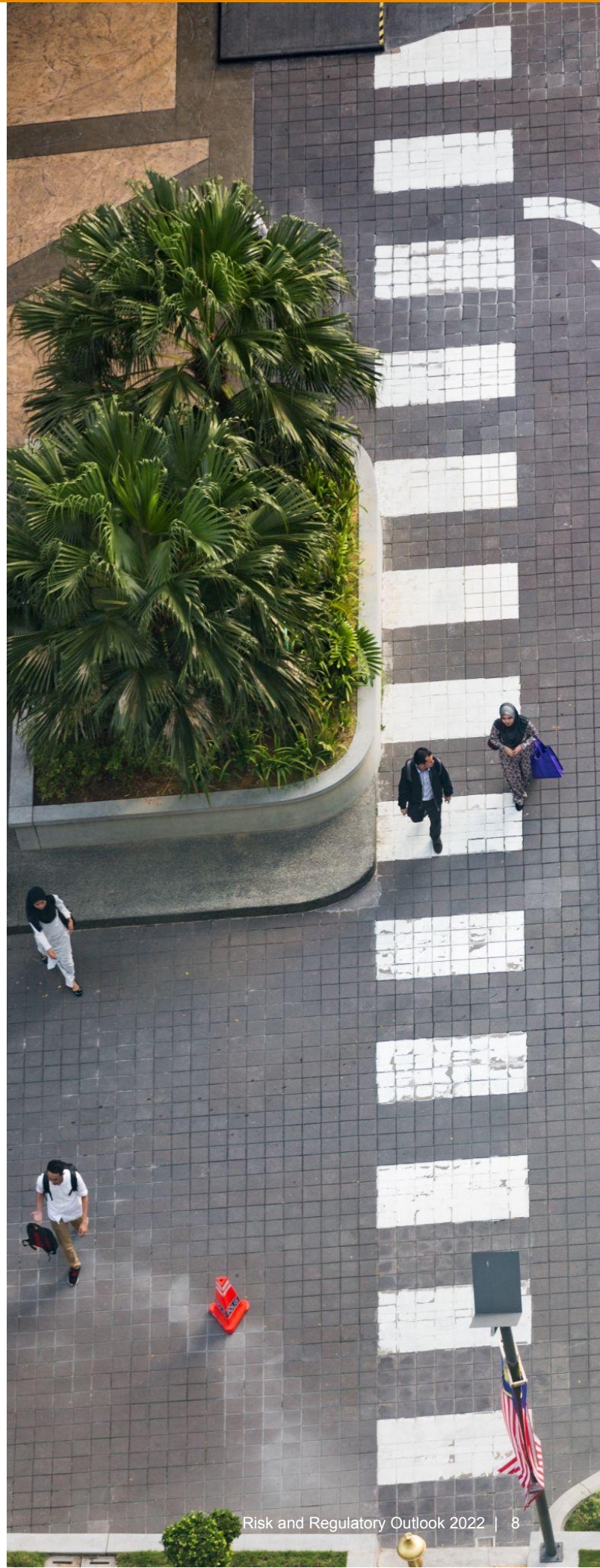


Figure 4: Comparison of taxonomies in Southeast Asia

	Singapore: GFIT Taxonomy	Malaysia: Climate Change and Principle-based Taxonomy (CCPT)	Indonesia Green Taxonomy Edition 1.0
Environmental Objectives	<ol style="list-style-type: none"> 1. Climate change mitigation 2. Climate change adaptation 3. Protect biodiversity 4. Promote resource resilience <p>+ Do-no-significant-harm clause</p>	<ol style="list-style-type: none"> 1. Climate change mitigation 2. Climate change adaptation 3. Prevent, reduce and control pollution 4. Protect healthy ecosystems and biodiversity 5. Use energy, water and other natural resources in a sustainable and efficient manner <p>+ No-significant-harm-to-the-environment guiding principle</p>	<ol style="list-style-type: none"> 1. Climate change mitigation 2. Climate change adaptation <p>+ Do-no-significant-harm clause</p>
Progress	<p>Public consultation ended, GFIT to assess feedback received.</p> <p>Consultative paper issued in 2021, no subsequent version or draft published yet.</p>	<p>Finalised.</p> <p>Effective from 30 April 2021 onwards, with a focus on manufacturing, oil and gas, construction and infrastructure sectors in 2021.</p>	<p>Version 1 was published in January 2022 with effectiveness date not being specified.</p> <p>However, OJK indicates that regulations covering reporting and green financing instruments will make reference to the green taxonomy.</p>
Applicability	<p>Upon finalisation, the SG taxonomy is expected to be applicable for Singapore-based financial institutions.</p>	<p>Financial institutions supervised by Bank Negara Malaysia</p>	<p>Indonesia's financial services sector</p>
Sectors in Scope	<ul style="list-style-type: none"> ● Agriculture and Forestry / Land Use ● Construction / Real Estate ● Transportation and Fuel ● Energy (incl. upstream) ● Industrial ● Information and Communications Technology ● Waste/Circular Economy ● Carbon Capture and Sequestration 	<p>No particular sector selection - examples include</p> <ul style="list-style-type: none"> ● Renewable Energy (Solar PV energy, Bioenergy, Hydro energy) ● Palm Oil ● Energy Efficiency ● Transport ● Building ● Manufacturing ● Waste ● Forestry 	<p>Based on Indonesia Standard Industrial Classification (KBLI) includes</p> <ul style="list-style-type: none"> ● Agriculture, Forestry and Fisheries; ● Mining and Exploration; ● Processing Industry; ● Procurement of electricity, gas, steam/hot water and cold air; ● Water management, wastewater management, waste management and recycling, and remediation activities; ● Construction; ● Wholesale and retail traded; repair and maintenance of cars and motorcycles; ● Transportation and warehousing; ● Provision of accommodation and provision of food and beverage; ● Information and communication; ● Financial and insurance activities; ● Real estate

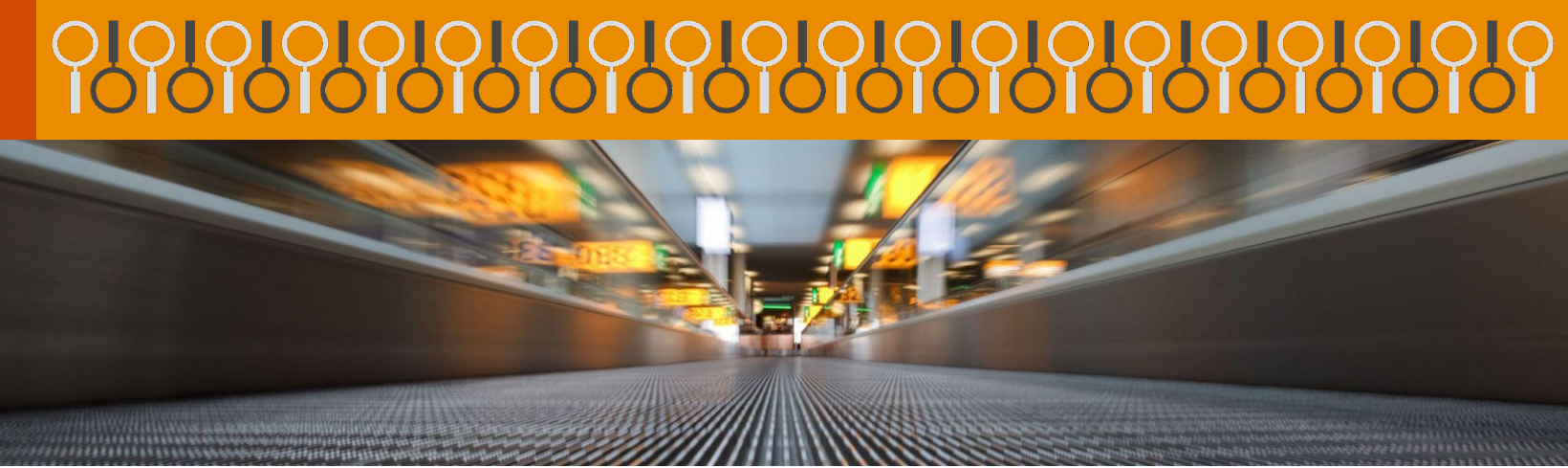


Figure 5: Comparison between ASEAN Taxonomy and EU Taxonomy

	ASEAN Taxonomy - Version 1	EU Taxonomy (852/2020/EU)
Environmental Objectives	<ol style="list-style-type: none"> 1. Climate change mitigation 2. Climate change adaptation 3. Protection of healthy ecosystem & biodiversity 4. Promotion of resource resilience and transition to circular economy <p>+ "Do No Significant Harm" essential criteria</p>	<ol style="list-style-type: none"> 1. Climate change mitigation 2. Climate change adaptation 3. The sustainable use and protection of water and marine resources 4. The transition to a circular economy 5. Pollution prevention and control 6. The protection and restoration of biodiversity and ecosystems <p>+ "Do No Significant Harm" clause</p>
Progress	Finalised Version 1 published in November 2021, consultation process underway for the next phase of Taxonomy development.	<p>Taxonomy regulation came into force on 12 July 2020.</p> <p>Technical screening criteria are set out by the EU Commission in Delegated Acts, of which the first on sustainable activities for climate change adaptation and mitigation objectives became effective on 4 June 2021.</p>
Applicability	<p>The first version of the ASEAN Taxonomy "is meant to provide a framework for discussions" according to its foreword. It can be applied voluntarily by financial services companies active in the region.</p> <p>Over time, national regulation in the ASEAN Member States (AMS) might make reference to the ASEAN taxonomy.</p>	<p>Addressees include member states, financial market participants offering financial products in Europe and other companies subjected to non-financial disclosure requirements.</p> <p>Other standards and regulations, including but not limited to disclosure, investment product classifications and the EU Green Bond Standard, refer to the Taxonomy and its annexes.</p>
Sectors in Scope	<p>The ASEAN Taxonomy comprises two parts: Foundation Framework & Plus Standard.</p> <p>"Foundation Framework" is sector-agnostic</p> <p>"Plus Standard" covers</p> <ul style="list-style-type: none"> ● Agriculture, forestry, and fishing ● Manufacturing ● Electricity, gas, steam, and air conditioning supply ● Transportation and storage ● Construction & Real estate activities ● Water supply; sewerage, waste management and remediation activities 	<p>Sectors covered in the annexes include:</p> <ul style="list-style-type: none"> ● Forestry ● Environmental protection and restoration activities ● Manufacturing ● Energy ● Water supply, sewerage, waste management and remediation activities ● Transport ● Construction and real estate ● Information and communications ● Professional, scientific and technical activities ● Financial and insurance activities* ● Education* ● Human health and social work activities* ● Arts, entertainment and recreation*

Figure 6: A comparison of green and transition taxonomies across the region

	Summary
Environmental Objectives	<p>All taxonomies and draft taxonomies include climate change mitigation as the primary objective in their current version. Climate change adaptation is the second objective across all papers - in the ASEAN Taxonomy, this objective will be further addressed in the so-called “Plus Standard” in subsequent versions.</p> <p>Other environmental objectives, including biodiversity as another common theme across all papers, differ. This reflects regional differences and differing political and regulatory priorities. However, granular criteria and requirements for the assessment of activities against these objectives - beyond principle-based assessment as proposed in the Malaysia Taxonomy - are pending completion.</p> <p>All taxonomies require that eligible activities must not cause harm to the environment (often referred to as a “Do No Significant Harm (DNSH)” clause).</p>
Progress and effective date	<p>The Malaysia Taxonomy is finalised. The first phase of the ASEAN and Indonesia Taxonomy development is completed, the next phase is underway. Singapore conducted a consultation on a national taxonomy in 2021. In the EU, the taxonomy regulation is effective while technical screening criteria has only been introduced for two of the six objectives so far.</p>
Applicability	<p>All taxonomies are intended to provide guidance to the financial services sector in their respective jurisdictions. It is expected that further regulations in the area of sustainable finance, including disclosure requirements, for instance, will make reference to the respective taxonomies.</p> <p>As one of the first adopters of a green taxonomy, the EU has already issued separate regulations on company- and product-level disclosures that require firms to classify against criteria of the taxonomy.</p> <p>Depending on their operations and investment projects, FIs are likely subject to more than one jurisdiction’s taxonomy, e.g. if they are resident in one country and operate in another country.</p>
Sectors in Scope	<p>The selection of sectors typically reflects the materiality of industries against the environmental objectives of taxonomies. In addition, differences between countries and regions are taken into account.</p> <p>Sectors common across taxonomies include:</p> <ul style="list-style-type: none"> ● Agriculture ● Energy ● Transport ● Waste management ● Industrial and manufacturing <p>The Malaysia Taxonomy is generally sector-agnostic, while the EU Taxonomy as well as the first version of the Indonesia Taxonomy comprise sector-specific assessment criteria. The ASEAN Taxonomy, on the other hand, adopted a sector-agnostic approach in the current version (“Foundation Framework”) while stipulating sector-specific criteria for the “Plus Standard” in subsequent versions.</p>





Impact of taxonomies - market insights from other parts of the world



#1 Companies: Taxonomies will require companies in the real economy to transform their business

According to an S&P Global analysis¹⁰, about 73% of revenues generated by the 500 largest U.S. companies, and 69% of revenues by the 1,200 largest global companies were not EU Taxonomy-aligned. The manufacturing sector contributed the largest percentage of EU Taxonomy-aligned revenues in both the U.S. and globally, followed by the construction and real estate and information and communications sectors. Other sectors will need to follow suit to keep up with developments.



#2 Asset & Wealth Management: Taxonomies will affect investment fund market

In Europe, a joint study by PwC and Morningstar¹¹ was done on the state of ESG disclosure in asset and wealth management. According to the study, an estimated 22% of the overall number of funds on the European fund market and up to 32% of European assets under management (AUM) are funds classified as having environmental characteristics or sustainability goals (according to the EU's Sustainable Finance Disclosure Regulation). Furthermore, 56% of the respondents expect a major increase (>50%) in such sustainable investment funds. On the other hand, 27% of distributors plan to completely discontinue the sales of conventional products.

Further research by Morningstar¹² highlighted trends within EU companies that indicated a shift towards the sustainable fund market. Sustainable funds attracted all-time high inflows of €120 billion in the first quarter of 2021. This is 18% higher than in the previous quarter and represents more than half of overall European fund flows. Meanwhile, sustainable fund assets increased by 17.5% over the quarter, reaching a record high of €1.3 trillion.



#3 Banks: Taxonomies welcomed but their implementation poses a challenge

Banks generally view the EU Taxonomy as a positive initiative to strengthen sustainable finance by bringing consistency and transparency to the industry, as they believe that a common set of definitions would enhance their approach to managing all aspects of ESG, including how they interact with clients. However, banks see the lack of quality data as a major challenge in the application of the EU Taxonomy¹³.

¹⁰ S&P Global Analysis, "[Investors grapple with lack of taxonomy alignment as final rules still to come](#)", 2021

¹¹ PwC-Morningstar study, "[The state of ESG disclosure in Asset & Wealth Management - From fund issuer to end investor](#)", 2021

¹² Morningstar, "[Sustainable fund flows hit new record](#)", 2021

¹³ The European Banking Federation (EBF) and the United Nations Environment Programme Finance Initiative (UNEP FI) have also worked together in January 2021 to launch the report - "[Testing the application of the EU Taxonomy to core banking products: High level recommendations](#)".

Challenges for financial services firms and recommendations

The introduction of taxonomies across Southeast Asia and other parts of the world will affect the way banks, institutional investors, and asset and wealth managers do business going forward. Firms need to tackle adoption and implementation challenges in areas such as:

- Strategy
- Products
- People
- Processes
- Regulatory developments
- Data

While regulatory compliance with the taxonomy and the evolving regulatory ecosystem is one of the key objectives, leading firms embrace and adopt strategic and business opportunities resulting from the region's evolving taxonomy.

This section illustrates some of the key challenges as well as best practices for the adoption of taxonomies.



Strategy:

Coherence of bank and asset managers' ESG strategy and risk management with the implementation of taxonomies



Products:

Demand for taxonomy-compliant lending and investment products

Many financial firms in the region have been pursuing sustainability objectives in their vision and strategy. The introduction of taxonomies requires an assessment - and potentially an alignment - of firms' approaches to sustainability against standards set out in the taxonomy.

According to an S&P Global Analysis¹⁴, less than a third of revenues generated by the 1,200 largest global companies are aligned with criteria defined in the EU Taxonomy. At the same time, a sample of 29 EU banks reported an average "Green Asset Ratio" of taxonomy-aligned exposures of 7.9%.¹⁵

These numbers highlight the need for green and sustainable investments in the real economy as well as the huge demand for sustainable financing and investing in the future.

Recommendations

- Organisations need to align their sustainability strategy and their ESG risk management with the requirements of taxonomies and related regulations in their jurisdictions, and jurisdictions in which they operate.
- This includes but is not limited to:
 - Ensuring coherence of strategy, risk management and the regulatory environment across all relevant jurisdictions
 - Identifying financing and investment opportunities with taxonomy-aligned companies and projects
 - Revamping the product range
 - Review of positive and negative screening criteria and approaches

Recommendations

- Green CAPEX will be the dominant driver of the transition of economies and businesses.
- This is a significant opportunity for investors and lenders to provide the much-needed funds for sustainable and transitional activities.
- Private investors and bank customers are increasingly aware of the impact they can make. Front runners can leverage this opportunity and offer taxonomy-aligned products to satisfy customer demands and contribute to the improvement of their own sustainability profile.

¹⁴ S&P Global, "Investors grapple with lack of taxonomy alignment as final rules still to come", 2021

¹⁵ EBA, "EBA publishes results of EU-wide pilot exercise on climate risk", 2021



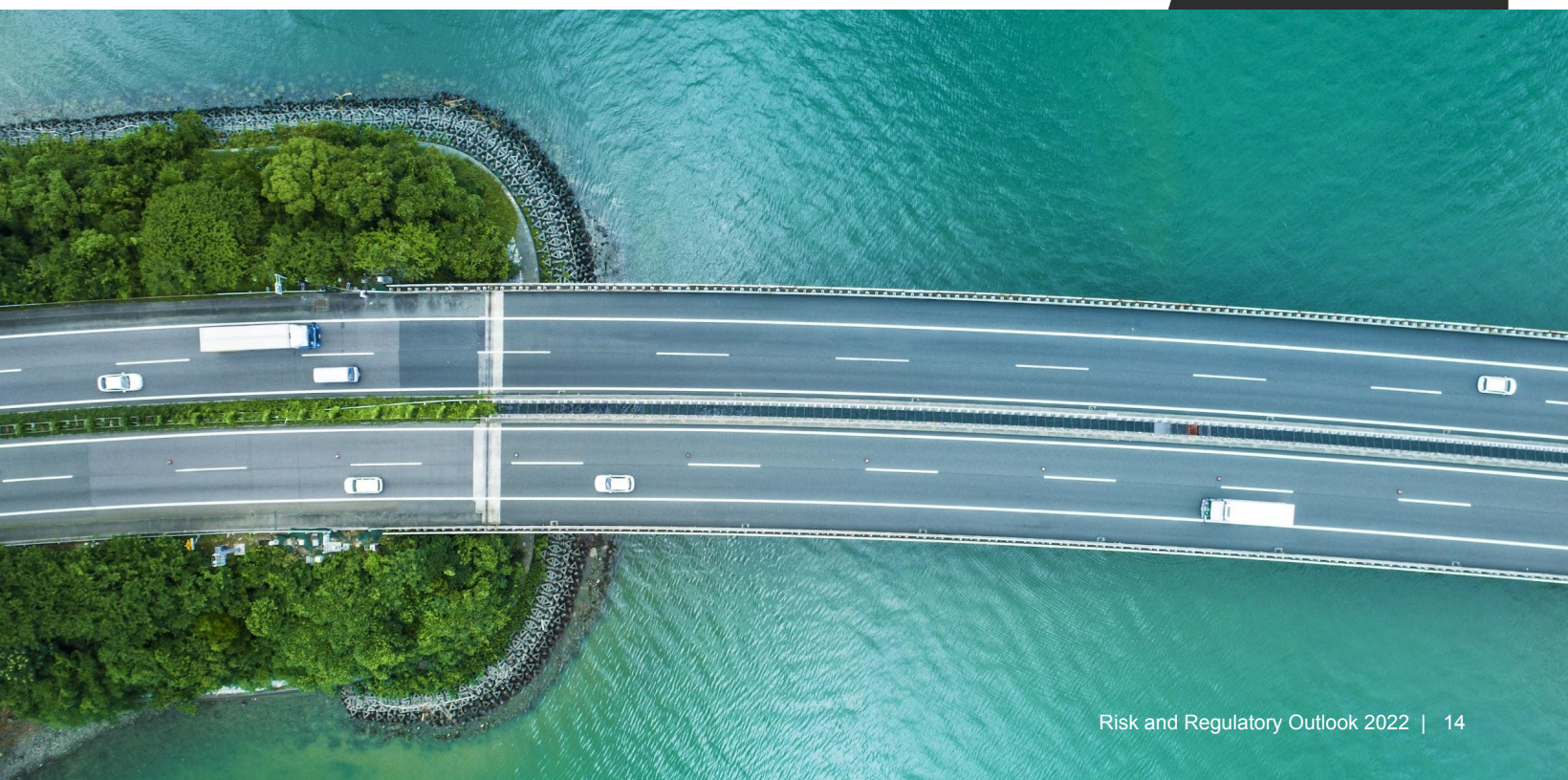
People:

Greater demand for ESG capabilities across the entire organisation

As sustainability is becoming an increasingly important topic for all financial institutions, there will be a greater need for ESG expertise and capabilities across multiple business units. Understanding ESG is imperative for front office, back office, risk management and other functions - but also for the board and senior management of an organisation. Evolving taxonomies across the region reinforce this trend.

Recommendations

- Classifications and criteria introduced by taxonomies require firms to rethink roles, responsibilities and skills.
- To augment their skills profile, firms need to increasingly focus on developing and redeploying internal talent as 'buying' this talent from the external market is becoming increasingly expensive and difficult to find.
- To move from a compliance-based response to becoming truly regenerative organisations, leaders need to define a compelling purpose and be deliberate in building a culture that reinforces it, including the right metrics and performance indicators for their people.





Processes:

Financial institutions will need to assess borrowers and projects against several taxonomies with different criteria

Regional and global financial institutions need to adopt and comply with several taxonomies from different jurisdictions. While most taxonomies share similar objectives, there are a number of important differences in the underlying details, such as industry classifications used, screening criteria (if available), and the granularity of disclosures. Many firms perform decentralised taxonomy assessments on a transaction-by-transaction level against applicable taxonomies in one or several jurisdictions.

Recommendations

- Financial institutions might aim to establish an efficient, global and automated taxonomy eligibility/alignment assessment process.
- As a starting point, banks and investors need to ensure the quality and sufficient granularity of data on the industrial sector classifications of their borrowers and the companies they invest in (investees) - ideally across all markets and national classification schemes.
- Globally active firms might consider developing or defining a global lead taxonomy across all jurisdictions that allows for the assessment of investments and exposures against all applicable national and regional taxonomies at the same time. This will streamline management, reporting and disclosure on taxonomy alignment across different countries.
- The lead taxonomy should also be consistent with pre-existing internal and external frameworks commonly used in the industry.



Regulatory developments:

Taxonomy-based reporting and disclosure requirements on the horizon, as already seen in Europe

In the wake of the release of its Taxonomy regulation, the European Union introduced taxonomy-based reporting and disclosure requirements for the financial services industry and beyond. Banks, for instance, will be required to disclose their taxonomy-related “Green Asset Ratio” (GAR) and their “Banking Book Taxonomy Alignment Ratio” (BTAR) while asset managers need to comply with “Sustainable Finance Disclosure Regulation” (SFDR) that references to the taxonomy. As countries in Southeast Asia progress in the adoption of global disclosure standards, such as the Global Reporting Initiative (GRI), the Task Force on Climate-Related Financial Disclosures (TCFD) and the Value Reporting Foundation (VRF), the inclusion of references to regional and national taxonomies into existing and upcoming reporting frameworks wouldn’t come as a surprise.

Recommendations

- Even without explicit regulatory requirements at this point, financial institutions should consider measuring their sustainability impact against the national and/or regional taxonomy, for management purposes, voluntary disclosure as well as potential future requirements.





Data:

Firms are concerned about the availability and quality of taxonomy-related ESG data

Data continues to be one of the greatest challenges to ESG adoption faced by financial institutions. The challenge is multi-faceted, ranging from a lack of harmonisation of data structures, differing requirements across jurisdictions, an evolving market for third-party data and related concerns, to a lack of reliability. On the other hand, firms tend to be hesitant to reach out to borrowers and companies, considering potential impacts on the relationship as well as operational challenges and unpredictable response rates.

Recommendations

- Financial institutions need to develop a sourcing framework and determine their data collection strategy based on business and regulatory needs. The framework should outline a methodology on how to collect taxonomy-relevant information.
- To start with, financial institutions need to identify and classify the granular economic activities of each company in their lending book or investment portfolio and map these activities to the industry codes in the taxonomy or taxonomies that they intend to work with. Subsequently, they need to determine which portion of those companies' revenue is stemming from these economic activities, and whether this qualifies them to be taxonomy-eligible.
- After having performed these analyses, financial institutions need to look into the more detailed technical screening criteria - where available - for which they are largely dependent on the disclosures of participants in the real economy. Depending on the sector and the level of maturity of clients/investees, financial institutions need to create an incremental approach to taxonomy alignment.
- Financial institutions need to assess the extent to which third party verification and reliance on industry-recognised certification schemes is possible in the application of technical screening requirements.
- Developing a sourcing framework includes developing technical solutions which facilitate the collection and management of data. A centralised electronic ESG data register may be established with the possibility of integrating data submitted by companies directly, and by that, improving the frequency and timeliness of data submission.
- Aligning the ESG-related requirements to other existing requirements is a key success factor. Other regulations and accounting standards, as well as audit requirements require granular, reconciled and complete datasets for reporting purposes. Leveraging on existing data initiatives, and making sure that source systems are uniform with aligned requirements, will be key in developing a sustainable approach for ESG data.

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