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Climate Change, Economy, and Financial System Interconnectivity

Malaysian Context

1 Physical Risks – When Nature Disrupts Business

Climate change is no longer a distant threat. It's already disrupting day-to-day operations:

- Floods in Shah Alam (2021): Hundreds of SMEs lost warehouses, machinery, and stock.
  No stock = no revenue = late loan repayments.
- Erratic rainfall in Kedah: Lower paddy and palm oil yields cut into farmers' income.
  Lower yields = tighter cash flows = higher default risk.
- Coastal erosion in Terengganu & Kelantan: Fisherfolk catch less, and their microloans become harder to service.
- Coral bleaching, extreme monsoons, and rising sea levels at Malaysia's eco-tourism hubs (Langkawi, Sabah, East Coast islands) : Disrupted domestic tourism and small hotels.
  Cashflow disruption leads to delayed interest / financing servicing.

➡️ **When nature strikes, it directly affects repayment capacity**

2️⃣ Transition Risks – Competing in a Low-Carbon World

Malaysia trades globally, and buyers are tightening sustainability rules.

- Palm oil & timber exporters: The EU now requires proof that products are deforestation-free. Non-compliance could shut out billions in exports.
- Automotive suppliers in Penang & Selangor: Japanese and European carmakers demand ESG standards. Fail to meet them, and local SMEs risk losing contracts.
- Energy-heavy industries: Cement and steel producers may face higher costs(carbon pricing, taxes, or subsidy cuts including stranded assets) as Malaysia moves toward Net Zero 2050.

➡️ Transition risks decide who stays competitive — and who gets left behind.

3 Liability & Reputation Risks – The Hidden Costs

Companies that ignore climate expectations may face lawsuits, fines, or reputational damage.

- Palm oil firms fined for illegal clearing.
- Manufacturers dropped by overseas buyers for not meeting ESG standards.

➡️ **Banks connected to these clients risk legal costs, reputational harm, and higher provisions.**

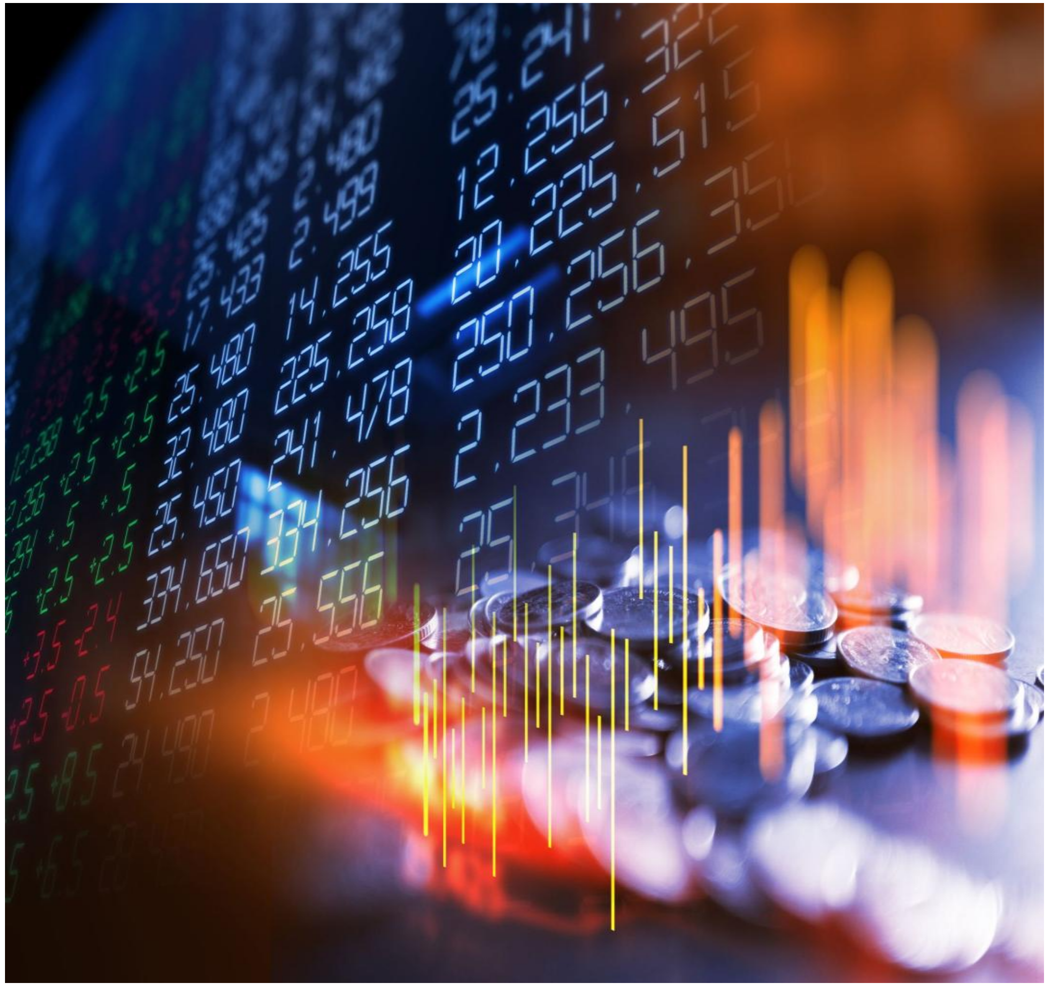
4 The SME Factor –

Malaysia's Real Economy Backbone

SMEs make up 97% of Malaysian businesses – and they are among the most vulnerable.

- Floods in Klang Valley (2021):
  Thousands of SMEs in Shah Alam, Klang, and Hulu Langat lost warehouses, inventories, and machinery. Many had insurance gaps, forcing them to rely on emergency restructuring of loans.
  - For banks: surge in NPLs (non-performing loans) and temporary loan moratoriums were needed.
- Logistics & Ports:
  Port Klang and Penang Port face disruption from heavy rains and sea-level rise, slowing down Malaysia's trade-dependent economy.
  - For banks: export/import financing may be delayed, impacting repayment schedules.
- Manufacturing SMEs:
  Floods or power outages (e.g., Kedah's industrial zones) halt production, delaying delivery to buyers.
  - For banks: trade facilities and working capital loans come under stress.

➡️ *Each SME default is not just one client issue. Multiply it across thousands — and it becomes a financial stability concern.*

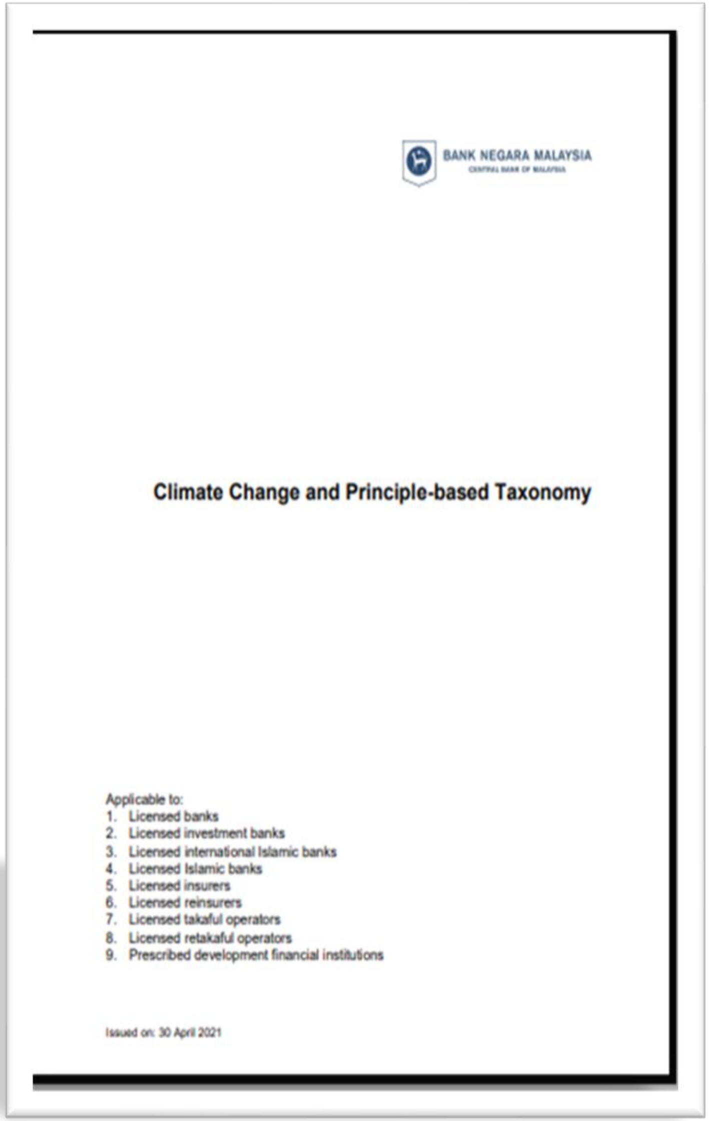


Spillovers into the Financial Sector

BNM's CCPT stresses that these economic shocks flow back into the financial system through:

- Credit Risk:
  - SMEs unable to repay loans due to flood losses or export contract cancellations.
  - Corporate borrowers in carbon-intensive industries see weakened balance sheets and downgraded credit ratings.
- Market Risk:
  - Asset values in oil & gas, coal, and unsustainable palm oil sectors decline as investors shift to greener portfolios.
- Insurance Risk:
  - Frequent floods, landslides, and crop failures push up insurance claims.
  - If not priced properly, insurers risk capital adequacy shortfalls.
- Systemic Risk:
  - Widespread floods (e.g., Klang Valley) simultaneously affect households, SMEs, corporates, and banks, amplifying contagion across the economy.

Why CCPT Matters for Bankers ?


BANK NEGARA MALAYSIA

CENTRAL BANK OF MALAYSIA

Climate Change and Principle-based Taxonomy

Applicable to:
1. Licensed banks
2. Licensed investment banks
3. Licensed international Islamic banks
4. Licensed Islamic banks
5. Licensed insurers
6. Licensed reinsurers
7. Licensed takaful operators
8. Licensed retakaful operators
9. Prescribed development financial institutions

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BNM's CCPT gives us a lens to classify clients:

- Green – supporting the transition, lower risk, preferential rates.
- Amber – in transition, potential growth opportunities with advisory financing.
- Red – harmful activities, higher risk, stricter conditions or pricing.

For RMs and credit officers, this isn't just compliance. It's a way to:

- ✓ Protect your sales book from future defaults.
- ✓ Spot new opportunities in transition financing.
- ✓ Position yourself as a trusted advisor – not just a lender.