

Norhana Endut: Navigating climate risk stress testing in Malaysia - catalysing dialogue and charting the course

Opening remarks by Ms Norhana Endut, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the workshop "Navigating Climate Risk Stress Testing in Malaysia: Catalysing Dialogue and Charting the Course", jointly organised by Bank Negara Malaysia (BNM) and the Joint Committee on Climate Change (JC3) Sub-Committee 1 Transition and Physical Risk Working Groups, Kuala Lumpur, 23 September 2024.

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A very good morning to everyone. It is my great honour to welcome you to this workshop on "Navigating Climate Risk Stress Testing in Malaysia: Catalysing Dialogue and Charting the Course", jointly organised by Bank Negara Malaysia (BNM) and the Joint Committee on Climate Change (JC3) Sub-Committee 1 Transition and Physical Risk Working Groups. This capacity building workshop brings together financial industry players and experts in related fields to share experiences, learn best practices and exchange ideas as we collectively prepare to conduct our first industry-wide climate risk stress test.

We firmly believe that climate change is an immediate challenge that poses risks to our financial system. To this end, allow me to describe how the central bank is approaching financial regulation in this space. In Malaysia, we have taken steps to put in place the foundational components to improve the ability of financial institutions to identify, measure and manage climate-related financial risks. There are five key pieces to these foundational components.

Firstly, a climate taxonomy establishes a consistent and common classification system for the identification of climate-related exposures. Second, mandatory climate disclosures by financial institutions will create an impetus for financial institutions to obtain information on their borrowers and investee firms. This, in turn, creates a virtuous cycle of informational flow. Third, regulatory standards on the management of climate-related risks set expectations for financial institutions to reflect these risks in their governance, strategy and risk practices. Fourth is a focus on transition planning. This is to ensure financial institutions set clear climate goals and concrete transition plans. With these building blocks in place, we are now in a good position for the fifth component, which is to accelerate industry capabilities via the conduct of the industry-wide climate risk stress test.

Ladies and gentlemen,

Allow me to shed more light on the motivation behind the implementation of the Climate Risk Stress Test. The exercise is primarily intended to enhance capacity building among financial institutions in assessing how their business and operations could be affected by climate risks. Throughout the journey of conducting the stress test, financial institutions will uncover gaps related to data, technology, and methodologies. This serves as a starting point for the institution to assess their internal capability and find

ways to address these gaps. In other words, the climate stress test is a forward-looking tool to help financial institutions in identifying, measuring and mitigating their climate risk exposures.

When designing this stress test for Malaysia, at Bank Negara Malaysia, we have strived to incorporate learnings from other jurisdictions, including adapting and incorporating several Malaysia's specific elements in terms of its economic structure and financial system. We have also incorporated feedback from domestic industry players. In this regard, I would like to take this opportunity to extend Bank Negara Malaysia's gratitude to many of you here who have provided invaluable feedback during the drafting of the Methodology Paper and reporting template. We truly appreciate the open and collaborative spirit extended by everyone, an approach that continues even up to today.

Climate risk stress testing is still in its infancy globally. Therefore, we have strived to balance between pragmatism and accuracy when specifying our requirements. Where possible we have tried to work around data limitations, lack of technical expertise as well as under-developed modelling techniques. However, considerable challenges remain for financial institutions to successfully run this stress test. We will journey with you through these challenges. It is as much a learning experience for Bank Negara Malaysia as it is for all the financial institutions running the stress test. That is one of the reasons we are all here today at this workshop.

I believe that together we can overcome many of the hurdles. Climate risk is a collective action problem. It may be in each individual's best interests to act selfishly, regardless of what other individuals do. However, if all individuals act selfishly, then the outcome for everyone is worse than if we all cooperate. At the country level we see this playing out in global emissions reduction. A single small country may feel that spending money to cut emissions may do little for global climate change, and hence choose not to do so. However, such situation could lead to some other, or even all, countries, to opt not to cut emission, and thus, we will end up in a bad outcome globally and having the adverse impact of unattended climate risks being faced collectively.

At the individual financial institution level, the development of new approaches and techniques for stress testing would be crucial for measuring the risk of climate change. However, if each entity chooses to keep their advancements proprietary, industry adoption will be slow. Collaboration and knowledge sharing is needed to scale solutions and reduce costs.

Therefore, I am hoping that for the next few hours, we will all make a conscious choice to participate in these sessions with a generous heart and an open mind. I hope everyone will choose to collaborate rather than compete, to share rather than hoard. In this regard, I am encouraged by the collective efforts by the industry in undertaking capacity building initiatives to upskill the financial institutions and exploring potential solutions to bridge the data gaps. Commendable efforts by the JC3 Sub-Committee 1 and 4 in leading training initiatives and Sub-Committee 5 in producing and refining the Climate Data Catalogue exemplify this collaborative spirit.

Ladies and gentlemen,

Some of you have been asking, what's next after this stress test? I'd like to address this in some detail.

Important to note is that the climate stress test, or CRST for short, is not an end in itself. It should not be viewed as merely a regulatory compliance exercise. Although BNM does not intend for the results of the inaugural stress test to calibrate capital requirements, we do expect financial institutions to take this exercise seriously. I strongly advise financial institutions to already start planning for how the results of the stress test could be used to inform strategic planning and management decision making.

CRST results are more than just numbers. They provide important insights into how climate risks could impact the business and operations of an institution. Hence, active engagement from senior management and the Board throughout the CRST journey – not just when the final results are available – will be crucial to the success of this first exercise. Financial institutions need adequate internal support to address the challenges they face, and this requires buy-in from the top throughout the stress test exercise.

Additionally, as climate risks continue to evolve, we expect climate risk stress tests to be a recurring exercise moving forward. As such, it is imperative that financial institutions continuously invest in enhancing their stress test capabilities, particularly in areas such as data collection, methodology and model development. This ongoing refinement is essential to ensure that the CRST remains relevant and responsive to the ever-evolving nature of climate risks.

Before I conclude, I want to emphasise the overarching objective of the Climate Risk Stress Test in safeguarding our financial system. Through CRST, we are not only strengthening our institutions' resilience to climate-related risks but also building a solid foundation for long-term sustainability.

This workshop today provides a great opportunity to kickstart meaningful conversations around CRST. The agenda has been carefully curated to promote deep learning and knowledge sharing, with a strong emphasis on practical applications and addressing real-world challenges in conducting the stress test. I encourage all participants to actively engage and share insights throughout the workshop.

Let me end with the words of Sir David Attenborough "If working apart we are a force powerful enough to destabilise our planet, surely working together, we are powerful enough to save it." I urge you to stay committed to this journey, continue collaborating, and share your experiences. While past and current actions and inactions created today's climate problems, our generation must lead the way in fixing it for our children. I have every confidence in our sector's ability to rise to this challenge and lead the way in building a climate-resilient financial system.

With this, I wish you a productive workshop ahead. Thank you.