# Malaysian Insurance Highlights 2022

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Malaysian Insurance Highlights

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# Content

# Foreword Malaysian Re

In December 2021 Malaysia was hit by the Great Malaysian Flood (GMF 2021), the most deadly and expensive natural catastrophe in its history, causing more than RM6 billion in economic losses and RM2 billion in insured losses, of which half a billion Ringgit was Malaysian Re's share of losses.

However, it is not only Malaysia that is increasingly affected by natural disasters. Throughout Southeast Asia, the pattern of the monsoon seems to have changed and devastating rainfalls have become more frequent. Climate change seems to be taking its toll.

The financial sector and in particular the insurance industry will play an important role in supporting the economy and society, mitigate the risks of climate change and support the country's transition to a low-carbon economy.

Bank Negara Malaysia (BNM) is at the forefront of encouraging Malaysia's insurers to reduce their climate-risk related exposure. In April 2021, the supervisor issued the Climate Change and Principle-based Taxonomy (CCPT), making it one of the regulatory pioneers in Southeast Asia in adopting a standardized classification system for climate-related risks. Later that year, the regulator released the draft Climate Risk Management and Scenario Analysis, which proposes climate risk management requirements and guidelines to ensure that financial institutions increase their resilience to climate-related risks and facilitate an orderly transition to a low-carbon economy.

While supporting the decarbonization of Malaysia's economy, insurers set themselves targets to contribute to lower or even to «zero-carbon» emissions and to better understand, manage and stress-test their exposure towards climate risks. The basis for this development is the Environmental, Social and Governance framework (ESG) which has gained momentum in recent years and turned into a governance standard by which corporations measure and report their impact on climate risk, but also demonstrate social responsibility and transparent business practices.

As Malaysian Re we are keen to show our industry's contribution and preparedness to managing climate risks, not only as experts in risk management and transfer, but also as corporate citizens. This year's Malaysian Insurance Highlights (MIH) focuses on the increasing relevance of environmental, social and governance (ESG) aspects and their implications for Malaysia's insurers.

We would like to express our deepest gratitude to the industry leaders who participated in the survey. Their invaluable contributions have enabled our researchers at Faber Consulting to make independent and comprehensive assessments, which you will find in refreshing clarity in this publication.

We are also grateful to Bank Negara Malaysia and the Malaysian General Insurance Association for their steadfast support of the initiative.

We hope that you will enjoy reading the study and we look forward to your valuable feedback.

**Zainudin Ishak**
President & Chief Executive Officer,
Malaysian Reinsurance Berhad

# Foreword Faber Consulting

Now in its fourth edition, we are proud to present to you this year's Malaysian Insurance Highlights (MIH). Our current issue examines the increasing relevance of the Environmental, Social and Governance (ESG) framework and its impact on Malaysia's insurers.

As almost all countries, Malaysia signed the Paris accord of the COP 21 in 2015 and committed to reduce its greenhouse gas emissions in order to limit global warming to 1.5 degrees Celsius. As risk managers, investors and risk carriers, the country's insurance industry is thought to play a key role in the transition of Malaysia's economy towards a less carbon intensive business model.

ESG will provide part of the framework to manage and measure that change, both from the perspective of the insurers' own ambitions as well as from Bank Negara's view, the country's central bank and supervisory authority of the insurance industry.

As in our previous editions, the Malaysian Insurance Highlights rests on two pillars: thorough market research and in-depth interviews with insurance executives operating in the country. This time we investigate the strategies applied by insurers to improve their ESG rating and look at the measures Malaysian Re takes to support its cedants. In our survey part we opened the floor to both chief executives and lead underwriters to weigh in on the readiness of the Malaysian insurance industry in incorporating ESG into their business models.

Once again we would like to express our deepest gratitude to Malaysian Re for facilitating this research project. In addition, we would like to thank our interviewees, representing different insurers, reinsurers, brokers and association members, who enabled this research by openly sharing their time and expertise with us.

We hope you enjoy reading this edition of Malaysian Insurance Highlights and find its insights useful.

**Henner Alms**
Partner
Faber Consulting AG

**Andreas Bollmann**
Partner
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# Methodology

The findings of this report are based on structured interviews with executives representing 12 Malaysian insurers, reinsurers, intermediaries and trade associations. The interviews were conducted by Faber Consulting, a Zurich-based research, communication and business development consultancy, from July to October 2022.

We would like to thank the following organizations for sharing their insight with us:

- AIG, Malaysia
- AM Best
- Berjaya Sompo Insurance Berhad, Malaysia
- Gallagher Re, Malaysia
- General Insurance Association of Malaysia (PIAM), Malaysia
- Great Eastern General Insurance (Malaysia) Berhad, Malaysia
- Malaysian Re, Malaysia
- MSIG Insurance (Malaysia) Bhd, Malaysia
- Progressive Insurance Berhad
- Swiss Re, Malaysia
- The Great Eastern Life Assurance Co Ltd
- Tokio Marine Kiln

# Executive summary

Energy will play a central role for Malaysia to achieve its sustainable growth and development goals. From 2010 to 2019, Malaysia's total energy consumption grew by 55 % with a CAGR of 5.1 %, with natural gas (CAGR of 13.6 %) and biofuels (CAGR 8.6 %) being the fastest growing sources. Total energy consumption (CAGR: 6.4 %) outgrew GDP (CAGR: 4.9 %) throughout this period.

While the share of coal as a source for electricity generation rose from 34 % in 2010 to 46 % in 2019, the share of natural gas fell from 57 % to 37 % over the same period. Fuel switching from natural gas to coal gained traction in Peninsula Malaysia during the past few years as coal has become much more economically competitive than natural gas in power generation. Nevertheless, the government has begun prioritizing clean energy and is aiming for a capacity mix of 25 % in renewables by 2025 in order to reduce its greenhouse gas emissions and to diversify its power fuel mix.

Albeit from a low base, hydro and solar power are currently the fastest growing sources of electricity generation, with a CAGR of 17 % (hydropower, since 2010) and 54 % (solar power, since 2012), respectively. In 2019, hydropower accounted for more than 90 % of renewable energy generation. The potential of geothermal, wind, and ocean energy as other renewable energy sources is also being explored. Although solar PV has been talked about as a long-term renewable energy source in Malaysia, it contributed only 0.5 % of total electricity generation in 2019.

## THE INSURANCE SECTOR WILL BE KEY IN TRANSITIONING TO A CLEANER ENERGY MIX

As a risk manager, investor and insurer, the insurance industry plays an important role in the transition to a global net zero economy. However, due to its strong bias on personal lines, there are limitations for Malaysia's insurers to accelerate the transition of the country's industry to a less carbon intensive business model. Between 2011 – 2021 Malaysia's total insurance premiums and takaful contributions grew by a CAGR of 3.2 %. Most of this growth can be attributed to life insurance and takaful life segment, which has achieved a CAGR of 4.5 %, resulting in an increased penetration from 3.1 % in 2011 to 3.9 % in 2021. The general (non-life) insurance and takaful market witnessed modest growth. Over the past decade the CAGR expanded by just 0.4 % in terms of gross written premiums and takaful contributions.

Motor insurance is by far the most important line of business for the 22 conventional insurance companies and four takaful providers. The line accounts for 46 % of the general insurance market and nearly two-thirds of the general takaful market, followed by fire insurance and health/personal accident insurance. The takaful market is predominantly a personal lines market, with the combined motor and health lines accounting for 75 % of the market, as compared to 57 % for general insurance.

In 2021, general insurance companies retained nearly 80 % of their premiums, while the retention rate in the general takaful market was even higher at 98.5 %. As in most non-life insurance markets, cession rates are typically much higher in commercial lines such as marine, aviation and transportation, CAR and engineering, liability and fire than in motor and medical. As a result, the commercial lines market will be far more affected by developments in the global reinsurance market.

## REGULATORY, INSURANCE AND FINANCIAL MARKETS INITIATIVES

Pressure to strengthen risk management on climate-related exposures comes from peers, international reinsurers as well as investors and financial markets. The Net-Zero Insurance Alliance (NZIA), launched by the United Nations, a group of insurers representing more than 14 % of global premium volume, has committed to transitioning their insurance and reinsurance underwriting portfolios to net-zero greenhouse gas (NTG) emissions by 2050. Among them, some of the world's largest reinsurers have already imposed restrictions on unconventional fossil fuels such as tar sands and Arctic oil and gas drilling. This will have a significant impact on the insurability of carbon-related risks, particularly for thermal coal and new oil and gas projects.

Malaysia's central bank, Bank Negara, is at the forefront of encouraging Malaysia's insurers to reduce their climate risk-related exposure. In April 2021, Bank Negara Malaysia (BNM) issued the Climate Change and Principle-based Taxonomy (CCPT), making it one of the regulatory pioneers in Southeast Asia in adopting a standardized classification system for climate-related risks. Later that year, the regulator released the draft Climate Risk Management and Scenario Analysis, which proposes climate risk management requirements and guidelines to ensure that financial institutions increase their resilience to climate-related risks and facilitate an orderly transition to a low-carbon economy.

Malaysia's insurers are also no strangers to managing their risks based on ethical principles. The Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) is intended to facilitate the implementation of an impact-based risk management system to assess the financing and investment activities of Islamic financial institutions in line with their VBI commitments. The VBIAF also serves as a reference for other financial institutions seeking to incorporate environmental, social and governance (ESG) risks into their own risk management systems.

Another regulatory initiative has been promoted by the Bursa Malaysia. In 2015 it published the so-called Sustainability Amendments to the Main Market and ACE Market Listing Requirements, requiring listed companies to include in their annual reports a statement on the management of material economic, environmental, and social risks and opportunities. Recently, the Exchange enhanced the reporting requirements further, demanding issuers listed on the Main Market to disclose material sustainability topics and indicators, align their disclosure with the Task Force on Climate-related Financial Disclosures and to report their performance on these topics over time. This initiative has also been adapted by the JC3 working group for Malaysia's insurance sector.

Finally, investors and lenders demand access to standardized ESG performance data to assess a company's ESG dimensions. Commercial data providers offer this information in the form of various ESG data points that are widely used by investors, although there is little clarity and agreement on definitions, including what ratings or data products should measure. Nevertheless, investors often rely on ESG scores as a first overview and impression on a company's performance. Direct $CO_2$ emissions are used as an indicator for the corporate climate footprint.

**SURVEY RESULTS**

ESG has assumed top relevance across Malaysia's insurance sector. However, it must be understood, that ESG in Malaysia refers predominately to the environmental aspects of the scheme, while both the social and the governance aspect receive less attention.

Most insurers confirm that they have already started to draw up their own processes how to include ESG in their underwriting and investment strategies as well as in their operations. They try and develop guidelines to categorize their risks and assets in those with a positive or negative impact on their overall ESG performance.

However, Malaysia's insurers are not yet in a position to follow a set strategy based on ESG criteria for their investment portfolio. Insurers struggle with the limited investment opportunities available. Firstly, the share of equities held by insurers is small. They are mostly invested in sovereign bonds, which – according to interviewees – have a negative ESG profile reflecting the country's bias as a fossil fuel exporter and consumer. Furthermore, the supply of green bonds or equities available is not as extensive and diversified as would be required for a substantial shift from conventional assets to those with a positive ESG profile.

On the upside, insurers expect green or sustainable investments to provide stable and robust returns, based on the assumption that they will be investing in long-terms assets geared towards generating predictable returns. In terms of renewable energy, risks and volatility might be higher, but therefore return expectations are also more ambitious, reflecting the large ramp-up investments needed to establish and expand the sector in Malaysia.

Malaysia's insurers are equally advanced on the liability side as on the asset side in implementing a strategy which reflects ESG requirements. Insurers have first defined exclusions from their portfolio, as these are the most obvious decisions. Most insurers agree that the insurance of coal fired energy plants, Arctic drilling or thermal coal will steadily be phased out. However, insurers emphasize that they must balance their environmental with their economic responsibilities and that they must assure a smooth functioning of the economies they are embedded in.

Insurers are preparing to take advantage of the enhanced focus on renewables and the electrification of the mobility sector. However, not all insurance products to be deployed are new, but might need solely a refinement to accommodate for the requirements to cover solar, hydro and wind energy risks. One of the key challenges though is still a lack in data and experience with the risks. While in some cases this may result in tighter limits or even exclusions as insurers decide to tread cautiously, the majority is moving forward covering risks related to renewables.

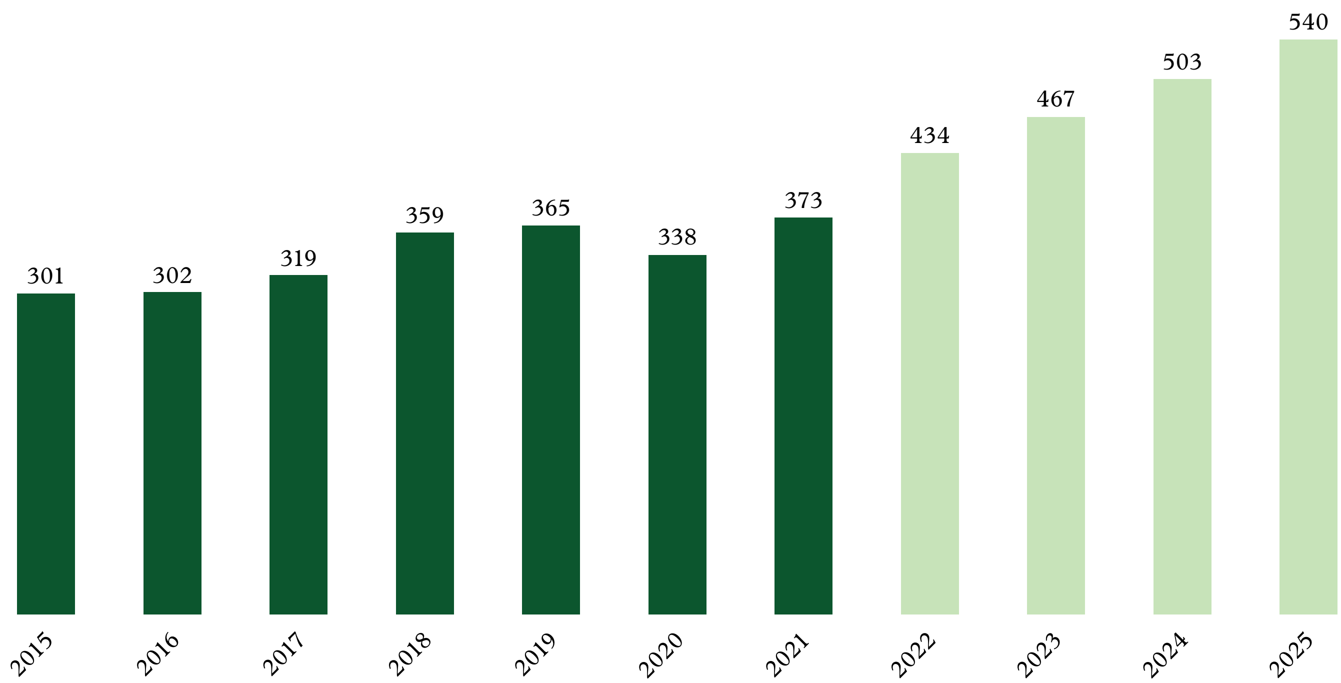
Nevertheless, demand is expected to grow, as a green infrastructure emerges which includes not only renewable energy plants but also the power grid as well as for instance charging facilities for electric vehicles. Thus far, this infrastructure is still largely built for an economy based on fossil fuel consumption and consequently, prices for renewable energy products still appear high and demand is slow. But Malaysia's insurers also notice the development in other emerging markets in Asia where the share of green energy – for instance solar plants – steadily grows.

# Malaysia: Economic and insurance market overview

**MALAYSIA'S GDP EXPECTED TO GROW AT AN ANNUAL RATE OF ALMOST 10 % UNTIL 2025**

Malaysia achieved an average annual GDP growth of almost 5 % in the 2015-2019 period before the pandemic, partly due to its open and diversified economy. During this period, inflation remained very low while per capita income increased. Because of Bank Negara's broad mandate and the use of a broad set of policy tools, such as government subsidies and price control measures, even the current inflation rate of 4.5 % in September 2022 stayed below the rate in many neighboring countries. A severe COVID-19 outbreak in mid-2021 led to stringent nationwide containment measures that pushed real GDP growth to 3.1 %. For 2022 the government projects GDP growth of more than 7 %, driven by both increased domestic and external demand.

**Chart 1: Malaysia Gross Domestic Product, 2015–2025, current prices, USD billion***
Source: IMF World Economic Outlook Database, October 2022
* Estimates start after 2021

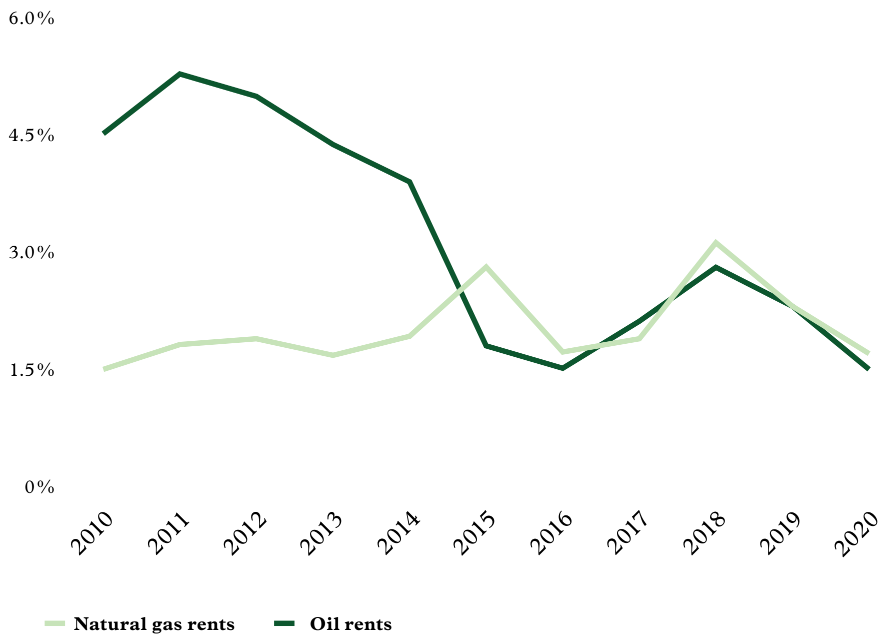


However, the pandemic will likely have an impact on the economy, lasting for the medium to long term. Recovery is expected to be uneven, and production could remain well below its potential. The 12th Malaysia Plan for 2021-25 therefore focuses on reducing regional development disparities, promoting a carbon-neutral economy and increasing labor productivity as well as improving transport infrastructure. The digital and green economies will be further enhanced and promoted, and fiscal governance will be strengthened. For the 5-year period of the 12th Plan, the IMF expects a GDP compound annual growth rate (CAGR) of 9.7 %.

### OIL AND GAS REVENUES OF DECLINING RELEVANCE

To consider the contribution of natural resources to a country's economic performance is important in providing an analytical framework for sustainable development. In some countries, revenues from natural resources, particularly fossil fuels and minerals, represent a significant portion of GDP, and much of this revenue comes in the form of economic rents. Natural resources generate economic rents because they are not extracted and often provide revenues that far exceed the cost of production. But these rents from non-renewable resources such as fossil fuels and minerals indicate the liquidation of a country's capital stock. When countries use such rents to support current consumption, rather than investing in new capital to replace the consumed capital, they are in effect borrowing against their future.

**Chart 2: Malaysia's natural gas and oil rents, 2010–2020, % of GDP**
Source: World Bank



The economic rents shown in chart 2 are calculated by estimating the price of units of oil and gas and then subtracting the estimated average cost of extraction per unit. These unit rents are then multiplied by the physical quantities that countries extract to determine the returns for each commodity as a share of GDP. The Malaysian energy industry serves as an important growth sector for the country's economy and is very important as a source to finance the country's economic growth. Over the past decade, combined fossil fuel rents from natural gas and oil exploitation have averaged 5.4 % of GDP, ranging from 7.3 % in 2011 to 3.4 % in 2016 and 2020.

Energy policy in Malaysia is set and overseen by the Economic Planning Unit (EPU) and the Implementation and Coordination Unit (ICU), which both report directly to the Office of the Prime Minister. In the past, the Malaysian government has focused on increasing hydrocarbon production through upstream investment and exploration to spur economic growth. However, pursuing this strategy has become increasingly challenging as production has declined due to maturing fields and a lack of developed new fields. As of 2019, Malaysia was the second–largest oil and natural gas producer in Southeast Asia and the fifth–largest exporter of liquefied natural gas (LNG) in the world.

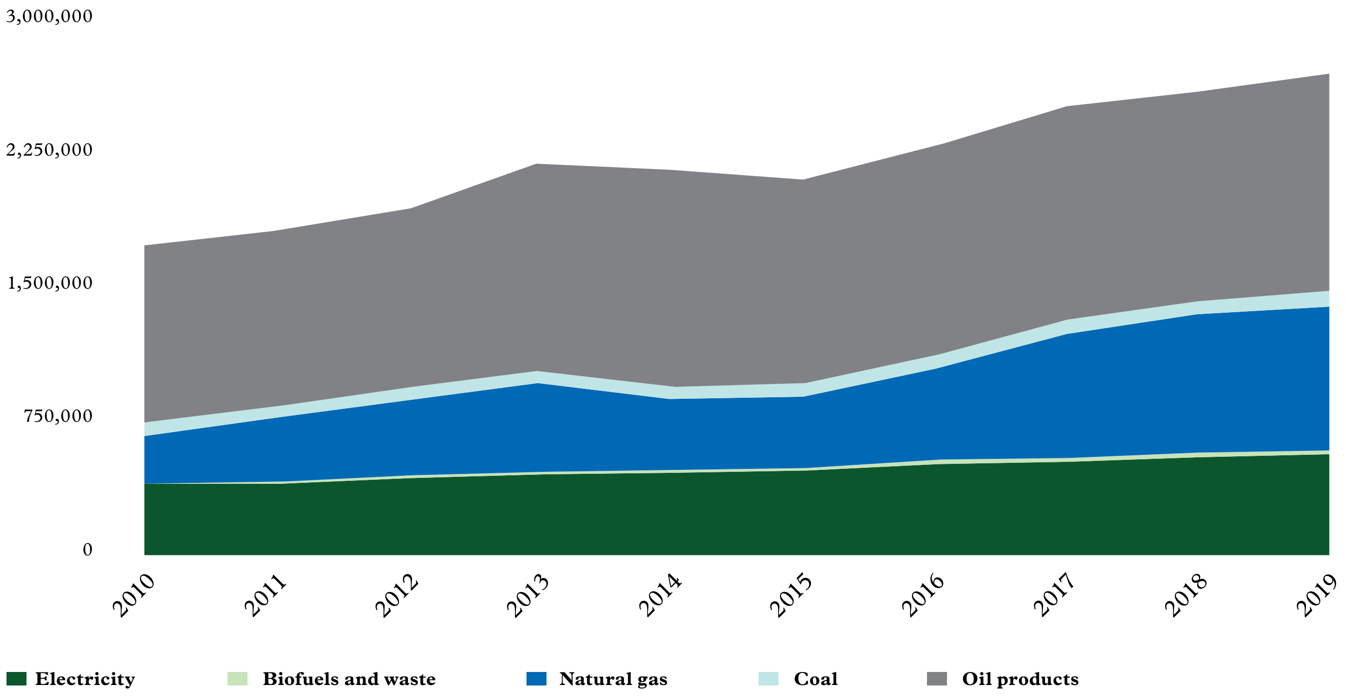
### SHIFT FROM ENERGY ACCESSIBILITY AND AFFORDABILITY TO ENERGY EFFICIENCY AND CONSERVATION

Energy plays a central role in achieving Malaysia's sustainable growth and development goals. In the past, Malaysia's energy policy has focused on improving energy accessibility and affordability, as well as energy security. However, recognizing the need to improve its energy efficiency and conservation initiatives, the government introduced its first National Energy Efficiency Action Plan (NEEAP) in 2016, which runs through 2025. This plan provides tools for the successful implementation of energy efficiency strategies through the well-coordinated and cost-effective implementation of energy efficiency measures in the industrial, commercial and residential sectors.

### RAPID GROWTH OF NATURAL GAS CONSUMPTION

From 2010 to 2019, Malaysia's total energy consumption grew by 55 % with a CAGR of 5.1 %, with natural gas (CAGR of 13.6 %) and biofuels (CAGR 8.6 %) being the fastest growing sources. Total energy consumption (CAGR: 6.4 %) outgrew GDP (CAGR: 4.9 %) throughout this period. In addition, natural gas, which has increased its share of total energy consumption from 15 % in 2010 to 30 % in 2019, has replaced most of the lost combined share of coal and oil (from 62 % in 2010 to 48 % in 2019).

**Chart 3: Malaysia, total final energy consumption by source, 2010–2019, Terajoule**
Source: IEA Energy Statistics Browser




Malaysia produced about 3 million tons of coal in 2018, representing about 8 % of its total coal consumption. The country has limited domestic coal reserves, almost all of which are located in Sarawak. Malaysia relies heavily on coal imports, mainly from Indonesia and Australia. In 2019, Malaysia imported about 38 million tons.

The country's state-owned oil and gas company, Petroliam Nasional Berhad (Petronas), holds exclusive ownership rights to all oil and gas exploration and production projects in Malaysia, and its Petroleum Management Unit is responsible for managing all upstream licensing processes. Petronas holds interests in most oil and natural gas blocks in Malaysia, and Petronas' financial contributions to government revenue in the form of taxes, dividends, and cash payments accounted for approximately 35 % of total government revenue in 2019.

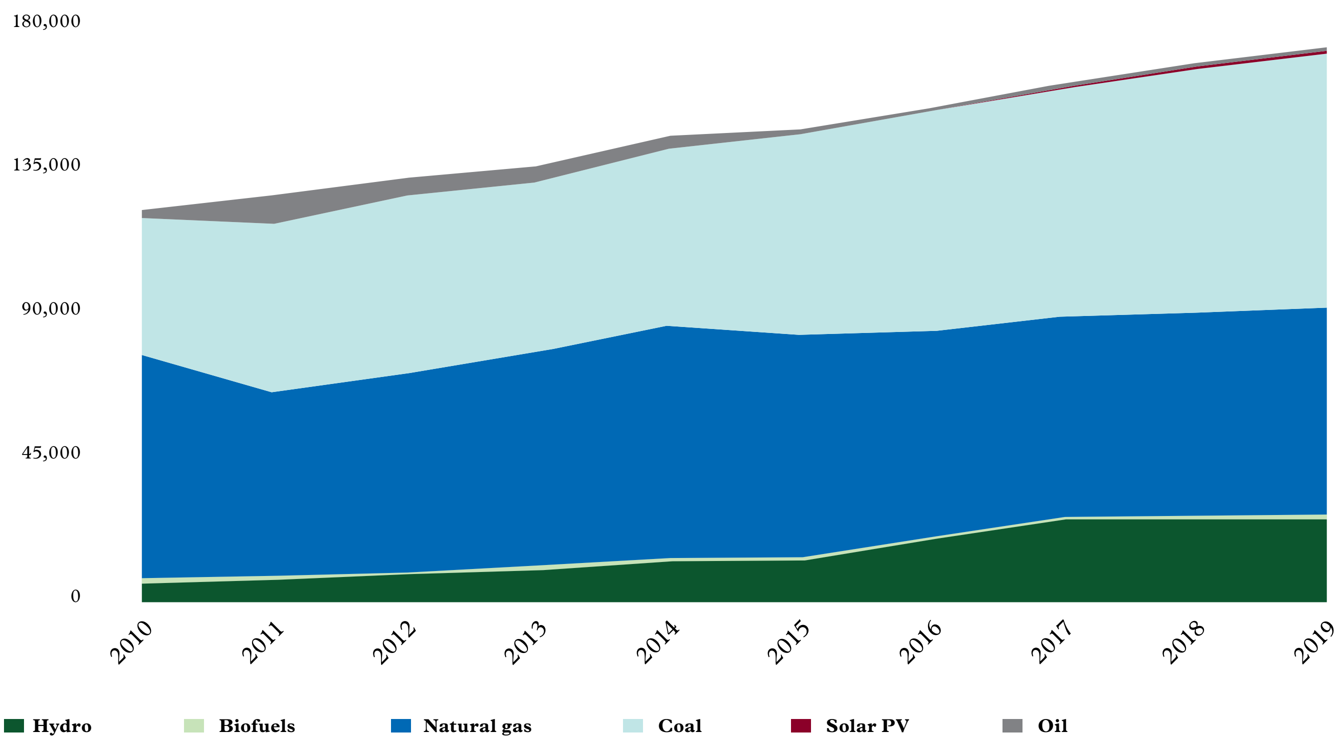
In Malaysia, there is currently a geographical imbalance between natural gas supply and demand: Peninsular Malaysia requires more natural gas for the power and industrial sectors, while the eastern states of Sarawak and Sabah on the island of Borneo produce natural gas. To meet the natural gas demand in Peninsular Malaysia, Petronas has developed two regasification terminals to secure supply from the global natural gas market. Both terminals are connected to the major natural gas pipeline network that transports natural gas for domestic consumption and for export to Singapore and have begun commercial LNG bunkering services as part of the Malaysian government's intention to become a regional LNG bunkering center.

**THE SHARES OF COAL AND HYDROPOWER IN ELECTRICITY GENERATION ARE GROWING**

From 2010 to 2019, total electricity generation grew at a compound annual growth rate of 3.9 %, slower than total energy consumption and GDP. Compared with energy consumption, an opposite trend can be observed in electricity generation: While the share of coal as a source for electricity generation rose from 34 % in 2010 to 46 % in 2019, the share of natural gas fell from 57 % to 37 % over the same period. Fuel switching from natural gas to coal gained traction in Peninsula Malaysia during the past few years, prompting utilities and power companies to develop more coal-fired capacity in the country. The main reason is that coal has become much more economically competitive than natural gas in power generation.

The Ministry of Energy, Science, Technology, Environment, and Climate Change devises policy related to electricity, renewable energy, and energy efficiency in Malaysia. A few years back, the government has begun prioritizing clean energy and aims to achieve a capacity mix of 25 % in renewables by 2025 in order to reduce its greenhouse gas emissions and to diversify its power fuel mix. Albeit from a low base, hydropower and solar power are currently the fastest growing sources of electricity generation, with a CAGR of 17 % (hydropower, since 2010) and 54 % (solar power, since 2012), respectively. Most of the renewable energy comes from hydropower plants in Peninsular Malaysia, Sabah, and Sarawak. In 2019, hydropower accounted for more than 90 % of renewable energy generation. The potential of geothermal, wind, and ocean energy as other renewable energy sources is also being explored. Although solar PV has been talked about as a long-term renewable energy source in Malaysia, it contributed only 0.5 % of total electricity generation in 2019.

**Chart 4: Electricity generation by source, 2010–2019, Terajoule**
Source: IEA Energy Statistics Browser

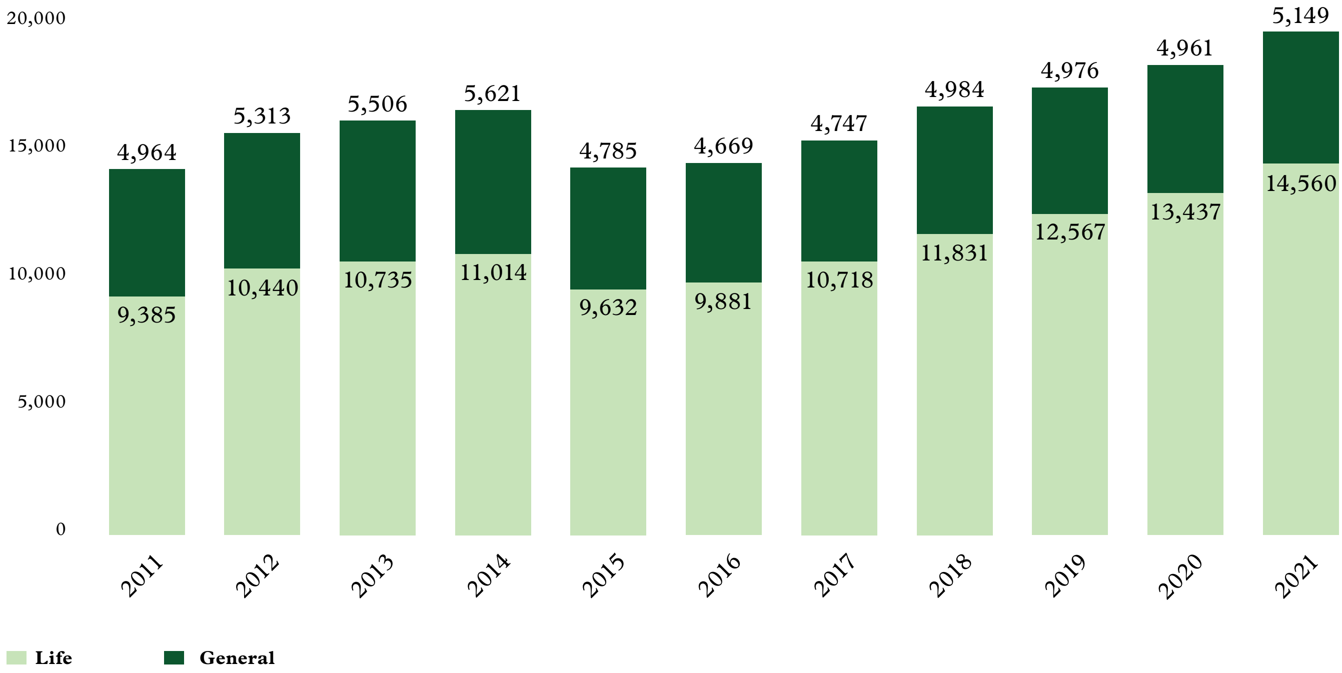


## GENERAL INSURANCE AND TAKAFUL SECTORS DECLINED IN ECONOMIC IMPORTANCE

Overall, total insurance premiums and takaful contributions have grown at a CAGR of 3.2 % from 2011 to 2021, which is higher than the GDP growth rate of 2.1 % during this period. However, most of this growth can be attributed to the life insurance and takaful life segment, which has achieved a CAGR of 4.5 %, resulting in an increase in life insurance and takaful penetration from 3.1 % in 2011 to 3.9 % in 2021. On the other hand, the general (non-life) insurance and takaful market in Malaysia has witnessed a very modest expansion over the past decade, with a compound annual growth rate of only 0.4 % in terms of gross written premiums and takaful contributions. As a result, the general insurance and takaful penetration declined from 1.6 % in 2011 to 1.4 % in 2021, indicating a lower economic relevance of this segment.

According to AM Best, most of the recent growth in the general insurance and takaful segment can be attributed to a post-COVID recovery in many lines of business, in particular fire and engineering. Furthermore, mainly due to a growth in motor, the general takaful segment grew much faster than insurance, increasing its share from 13 % in 2017 to 18 % in 2021.

**Chart 5: Life and general insurance direct premiums & takaful contributions written, 2011-2021, USD million**
Source: Faber Consulting AG, based on Swiss Re institute, sigma 4/2022, sigma-explorer.com




**Fitch Ratings 'A' (Strong) with a Stable Outlook.**

**A.M. Best 'A-' (Excellent) with a Stable Outlook.**

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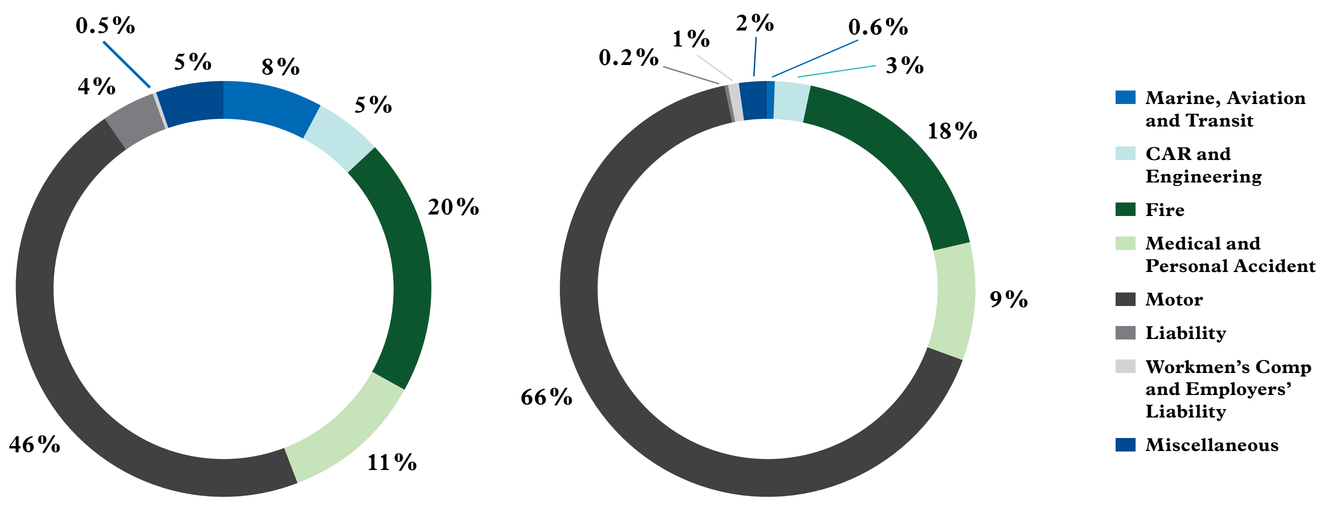
## MOTOR AND HEALTH ACCOUNT FOR MORE THAN 60 % OF THE TOTAL NON-LIFE MARKET

There are currently 22 conventional insurance companies and four takaful providers operating in the Malaysian general (non-life) market. In terms of 2021 gross written premiums, the top five players account for over 45 % of the segment, while the top ten account for 74 % of the market. General insurance business, as opposed to general takaful business, accounted for approximately 82 % of this market segment in 2021.

**Chart 6: General insurance lines of business split, 2021, RM million and percent (total market volume RM 17.732 million)**
Source: Bank Negara

**Chart 7: General takaful lines of business split, 2021, RM million and percent (total market volume RM 3.833 million)**
Source: Bank Negara




Motor insurance is by far the most important line of business, accounting for 46 % of the general insurance market and nearly two-thirds of the general takaful market, followed by fire insurance and health/personal accident insurance. As might be expected, the takaful market is predominantly a personal lines market, with the combined motor and health lines accounting for 75 % of the market – compared to 57 % for general insurance.

## HIGH RETENTION RATE IN GENERAL INSURANCE AND TAKAFUL

The overall retention rate in the general insurance and takaful market in Malaysia is high, mainly due to the dominant personal lines segment, which tends to be better diversified and less volatile than the commercial segment.

In 2021, general insurance companies retained nearly 80 % of their premiums, while the retention rate in the general takaful market was even higher at 98.5 %. As in most non-life insurance markets, cession rates are typically much higher in commercial lines such as marine, aviation and transportation, CAR and engineering, liability and fire than in motor and medical. As a result, the commercial lines market will be far more affected by developments in the global reinsurance market.

**Chart 8: General insurance premium retention and cession ratios, 2021, %**
Source: Bank Negara

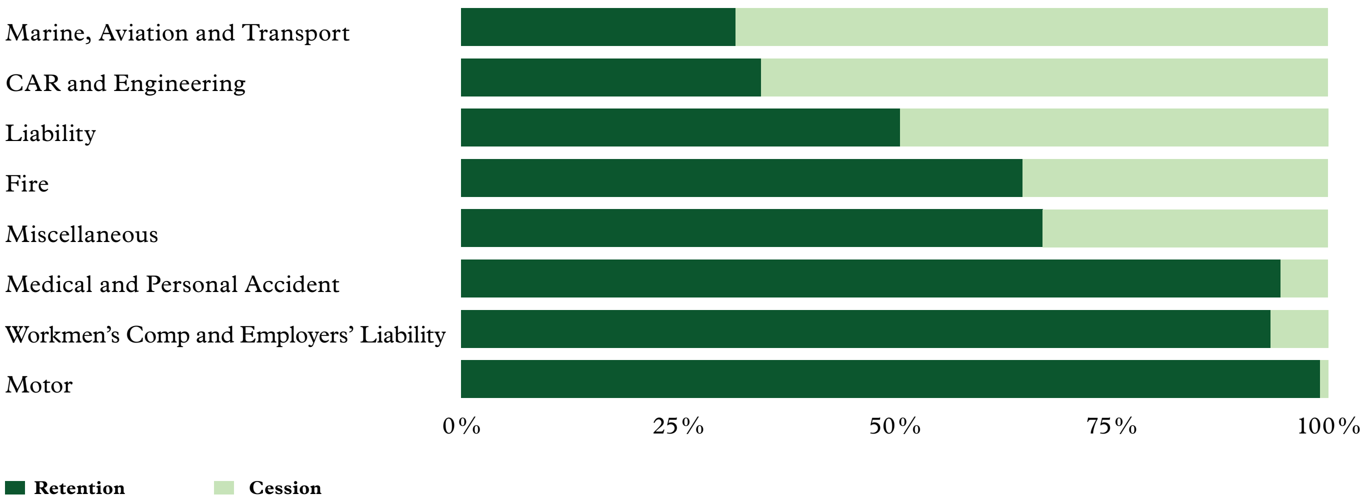
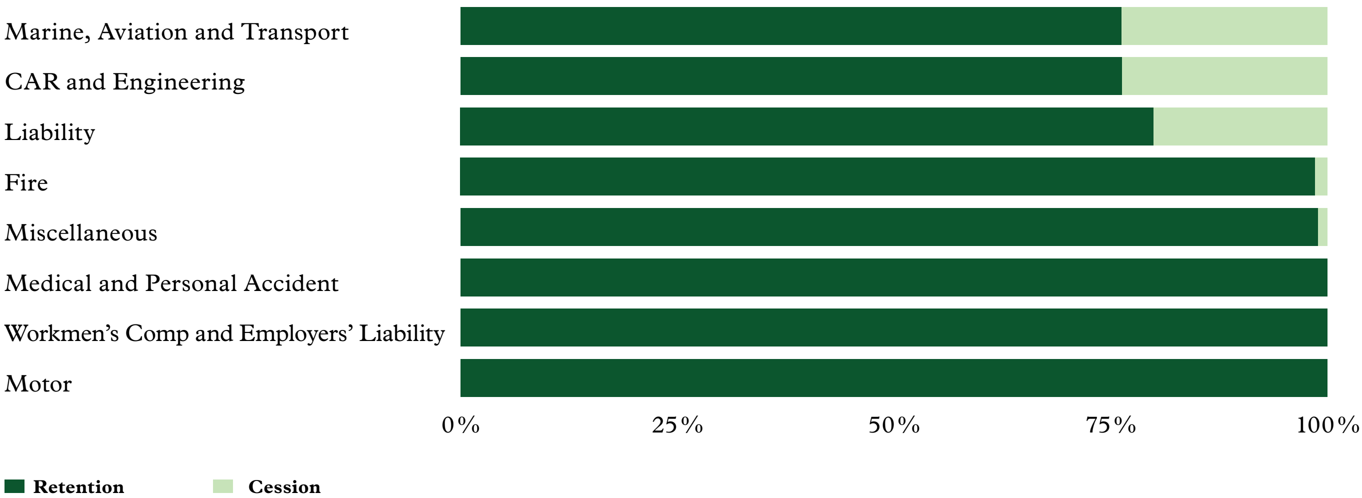


**Chart 9: General takaful retention ratio, 2021, %**
Source: Bank Negara



## NET ZERO INSURANCE ALLIANCE

As a risk manager, investor and insurer, the insurance industry plays an important role in the transition to a global net zero economy. The Net-Zero Insurance Alliance (NZIA), launched by the United Nations, is a group of over 29 leading insurers representing more than 14 % of global premium volume. Current members in Asia are Japanese insurers MS&AD, Sompo and Tokio Marine, and KB Insurance and Shinhan Life in Korea. The NZIA is convened by the UN Principles for Sustainable Insurance (PSI), the largest collaboration between the United Nations and the global insurance industry.

NZIA members have committed to transitioning their insurance and reinsurance underwriting portfolios to net-zero greenhouse gas (NTG) emissions by 2050, consistent with a maximum temperature increase of 1.5°C above pre-industrial levels by 2100, in order to contribute to the implementation of the Paris Climate Agreement.

**Table 1: Key principles considered core elements of best-practice net-zero insurance approaches**
Source: United Nations Environment Programme Finance Initiative (2022): Insuring the net-zero transition: Evolving thinking and practices

| | |
|---|---|
| **Achieving the GHG reductions required to meet a 1.5°C low or no-overshoot scenario in insurance activities, via long-term net-zero (2050) and interim (2030 or sooner) targets**<br>– Residual GHG emissions should be permanently removed from the atmosphere to achieve net zero<br>– Targets should align with just transition principles and the UN Sustainable Development Goals (SDGs) | **Supporting the real economy in its transition to net zero by 2050 or sooner via the insurance underwriting portfolio. This includes:**<br>– Engagement and stewardship with clients to achieve net zero, address risks and build climate resilience<br>– Advocacy for climate and energy policies (e.g. carbon pricing) aligned with achieving global net-zero emissions |
| **Taking meaningful measures to embed net-zero commitments in business practices**<br>– Appropriate governance and oversight of delivery of net-zero targets<br>– Development of specific policies to support delivery of net-zero goals (e.g. energy transition or deforestation policies) | **Acting now and disclosing activity to stakeholders**<br>– Disclosure of insurance-associated emissions<br>– Disclosure of the key actions that the organization is taking to support the real economy to transition and the impact of these actions |

It has been recognized that the transition to a resilient net-zero economy is likely to increase prosperity and to stimulate job creation. However, there will be challenges for workers, communities, cities and countries during this transition. To address this, insurance strategies that address climate change must take into account the social impacts that a rapid net-zero transition could cause, while ensuring that it is inclusive and that no one is left behind - a core principle of the UN Sustainable Development Goals.

**THE RE-/INSURABILITY OF COAL, OIL AND GAS RISKS WILL BECOME INCREASINGLY DIFFICULT**

Four of the largest global reinsurers, Hannover Re, Munich Re, SCOR and Swiss Re, are also members of the NZIA, the latter three being founding members. Their implemented underwriting policies are already linked to the overarching goal of reducing their insured and reinsured emissions to net zero by 2050 in order to meet the 1.5°C target.

All four reinsurers have in common that they have already imposed restrictions on unconventional fossil fuels such as tar sands and Arctic oil and gas drilling. In terms of thermal coal exposures, Munich Re is the only one of the four reinsurers that does not include any restrictions in its treaty portfolio, while the three others have recently also introduced exclusions for treaty reinsurance. However, Munich Re has committed to completely eliminating its exposure to thermal coal by 2040. With increasing pressure from legislators, investors and the business environment, including consumers, more insurers and reinsurers are expected to join the NZIA. This will have a significant impact on the insurability of carbon-related risks, particularly for thermal coal and new oil and gas projects.

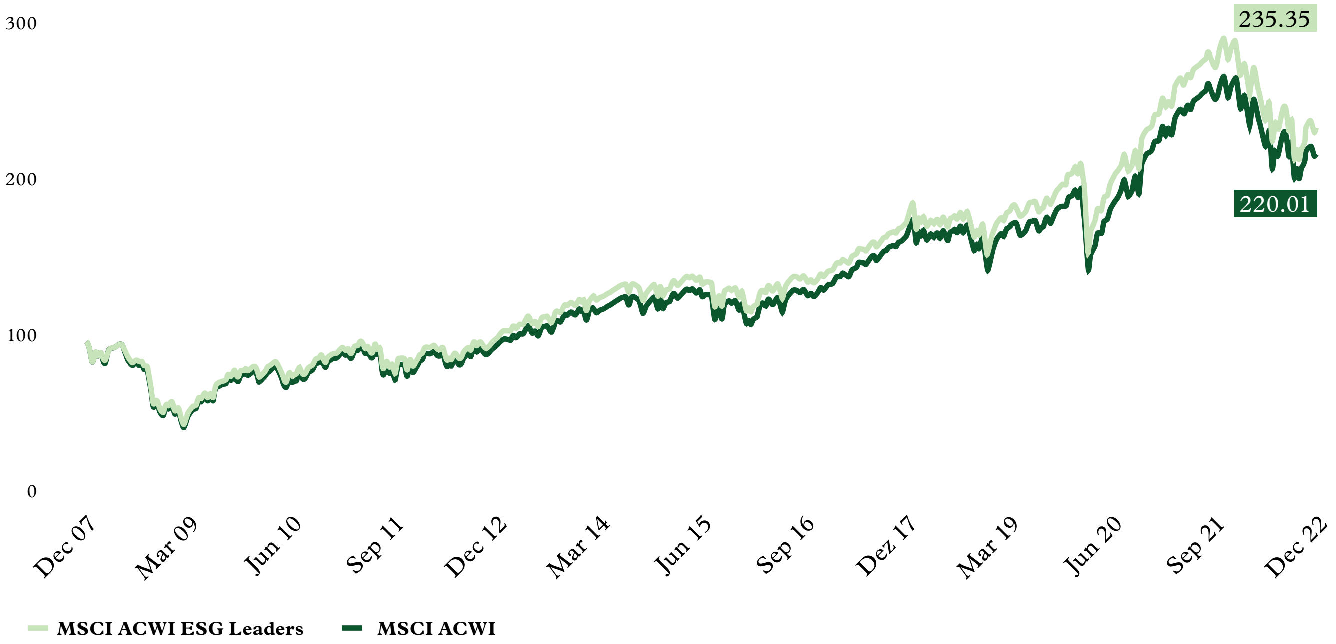
**Table 2: Coal and Oil & Gas underwriting policies of selected major global reinsurers**
Source: The Insurer (September 13, 2022): Europe's big four reinsurers lead industry's nascent exodus from conventional oil and gas

| | Hannover Re | Munich Re | Swiss Re | SCOR |
|---|---|---|---|---|
| **Coal underwriting policy** | | | | |
| Date of thermal coal underwriting policy adoption | April 2019 | August 2018 | July 2018 | September 2017 |
| Thermal coal stand-alone risk exclusions | No facultative reinsurance coverage for any planned and new coal-fired power plants and coal mines | No new coal-fired power plants or coal mines | Ban on old and new projects that have more than 30% of exposure to thermal coal | No direct or facultative reinsurance in respect of new thermal coal mines and in respect to the construction of new coal-fired power plants |
| Underwriting restrictions for companies active in coal and coverage of treaty reinsurance | Ban on companies that generate more than 30% of their revenues from activities in thermal coal | No company thresholds<br>No restrictions on treaty reinsurance | Ban on companies that have more than 30% of exposure to thermal coal, applicable to all direct, facultative and treaty coverages. | No company thresholds<br>Restrictions on treaty reinsurance since 2021 |
| Thermal coal threshold escalation / phase-out | No underwriting of coal-based risks in connection with power generation in its entire portfolio from 2038 onwards. | 5% reduction in GHG emissions and 35% in coal-related exposure in all direct and facultative business until 2025. Complete elimination of exposure by 2040. | Begin of tightening treaty conditions in 2023, coal phase-out by 2030 in OECD countries and by 2040 worldwide. | Coal phase-out by 2030 in OECD countries and by 2040 worldwide, applicable to all facultative and treaty coverages. |
| **Oil & Gas underwriting policy** | | | | |
| Date of conventional Oil & Gas underwriting policy adaption | March 2022 | n.a. | May 2022 | 2021 |
| Conventional Oil & Gas underwriting restrictions | From mid-2022, end of facultative coverage for projects associated with the exploration and/or development of new oil & gas reserves, upstream and midstream | No commitment – focus restricted to unconventional Oil & Gas exclusions only | End of coverage for new oilfield projects as of 2023. Exceptions allowed for projects of companies aligned with net-zero emissions by 2050. | Coverage exclusion for new Oil & Gas field projects. Exceptions allowed for projects of companies aligned with net-zero emissions by 2050. |
| Conventional Oil & Gas phase-out | No commitment | No commitment | Phase-out by 2030 from companies that are not aligned with net zero by 2050. | No commitment |

### BANK NEGARA ENSURES ENHANCED FINANCIAL RISK MANAGEMENT IN THE CONTEXT OF CLIMATE CHANGE

According to the Malaysian Investment Development Authority (MIDA), even though the adoption of ESG practices is still in its infancy by global standards, Malaysia compares very favorably with ASEAN countries. In the MSCI All Country Index (ACWI) ESG Leaders Index, which is comprised of large and mid-sized companies from 23 developed and 24 emerging markets, Malaysia – with 28 companies represented in the index – scored second highest among all ASEAN countries.

**Chart 10: MSCI All Country Index (ACWI) ESG Leaders Index – cumulative index performance[1] gross returns; USD**




The MSCI Malaysia ESG Leaders Index is a capitalization weighted index that provides exposure to companies with high Environmental, Social and Governance (ESG) performance relative to their sector peers. The index is a member of the MSCI ESG Leaders Index series and the constituent selection is based on data from MSCI ESG Research.

1 https://www.msci.com/documents/10199/9a760a3b-4dc0-4059-b33e-fe67eae92460

**Table 3: MSCI Malaysia ESG Leaders Index – top 10 constituents as of December 30, 2022**[2]

| | Index Wt. (%) | Parent Index Wt. (%) | Sector |
|---|---|---|---|
| Public Bank | 19.98 | 14.41 | Financials |
| Malayan Banking | 13.23 | 9.55 | Financials |
| Cimb Group Holdings | 12.54 | 9.05 | Financials |
| Press Metal Aluminium | 5.75 | 4.15 | Materials |
| Petronas Gas | 4.30 | 3.11 | Utilities |
| Digi.com | 3.95 | 2.85 | Comm Srvcs |
| PPB Group | 3.55 | 2.56 | Cons Staples |
| IHH Healthcare | 3.48 | 2.51 | Health Care |
| MISC BHD | 3.19 | 2.30 | Industrials |
| Nestle (Malaysia) | 3.13 | 2.26 | Cons Staples |
| **Total** | **73.11** | **52.74** | |

The country also holds a global leadership position in Sharia-compliant investment instruments: In 2021, Malaysia issued the world's first government-owned, U.S. dollar-denominated sustainability sukuk with 10-year trust certificates with a volume of USD 800 million. At the end of 2021, Malaysia accounted for USD 3.9 billion or 56 % of total ASEAN sustainable and responsible investment (SRI) sukuk issuance.[3]

2 https://www.msci.com/documents/10199/7ddf34bf-74d1-0b1d-ee65-fe07f72b45f7
3 https://www.mida.gov.my/mida-news/how-malaysia-scores-on-esg/

This process is largely induced by Malaysia's supervisory authorities and the stock exchange. In April 2021, Bank Negara Malaysia (BNM) had issued the Climate Change and Principle-based Taxonomy (CCPT) following a public and industry consultation, making it one of the regulatory pioneers in Southeast Asia in adopting a standardized classification system for climate-related risks. The taxonomy does not distinguish its application for Retail or Corporate customer segments. However, the guidance by design, appears to be more applicable to corporate customers, given that corporate segments have a comparatively higher carbon footprint and are more susceptible to climate risk given their longer facility term tenure.

In December 2021, BNM released the draft Climate Risk Management and Scenario Analysis, which outlines proposed climate risk management requirements and guidelines for financial institutions, including insurers and takaful operators. The specific requirements and expectations are intended to ensure that financial institutions strengthen the management of financial risks arising from climate change to increase the resilience of the financial sector to climate-related risks and facilitate an orderly transition to a low-carbon economy. Governance, strategy, risk appetite, and risk management requirements must be met by December 31, 2023, while scenario analysis, metrics, targets, and disclosure requirements must be met by December 31, 2024.

In June 2022 Bank Negara published a guide to facilitate the adoption of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations on climate-related disclosure. The guide is the outcome of one of several initiatives developed by the Joint Committee of Climate Change (JC3), a collaboration of Bank Negara, Bursa Malaysia and several financial institutions. Previously, several industry studies had found that the Malaysian financial services sector significantly lagged behind the global industry average in both the extent and quality of climate risk disclosure. Furthermore, Bank Negara aimed to incorporate recent climate disclosure initiatives, such as the Global Carbon Accounting Standard, developed by the Partnership for Carbon Accounting Financials as well as the development of global sustainability reporting standards, that builds on the recommendations of the TCFD.

The JC3 guide recognizes the urgency for Malaysia's financial institutions to accelerate efforts to manage its climate-related risks as well as opportunities and to intensify efforts to implement the TCFD Recommendations in phases beginning 2022. The guide outlines key recommendations to help financial institutions improve their disclosures. Financial institutions are encouraged to incorporate climate-related data into their reporting alongside other financial and non-financial data. Global practices serve as a benchmark for Malaysian financial institutions aspiring for a more robust level of climate governance and disclosure.[4]

4 Task Force on Climate-related Financial Disclosures (TCFD), application guide for Malaysian Financial institutions, Joint Committee on Climate Change (JC3), 29 June 2022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**MALAYSIAN TAKAFUL OPERATORS GUIDED BY BANK NEGARAS VBIAF**

The Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF), which serves only as a guideline for the industry, is intended to facilitate the implementation of an impact-based risk management system to assess the financing and investment activities of Islamic financial institutions in line with their respective VBI commitments. The VBIAF has been developed with reference to existing Bank Negara policy documents, in particular the Risk Governance, Credit Risk and Investment Management Guidelines for Takaful Operators, as well as standards and guidelines from international multi-stakeholder organizations and initiatives. It also serves as a reference for other financial institutions seeking to incorporate environmental, social and governance (ESG) risks into their own risk management systems. The design of the VBIAF is based on the following four principles:

I. **Attainment of benefit and prevention of harm**
Any financing and investment activities undertaken by the IFI would be evaluated against this premise of benefit and harm. This premise is entrenched in the requirements of Islam and is reflected in the application of Shariah.

II. **Integration of Shariah**
The integration of Shariah must extend beyond a compliance approach to affect real change in behavior and culture of the IFI towards embracing the VBI strategy.

III. **Fairness and Transparency**
Transparent policies and procedures and effective disclosures are important measures to facilitate the necessary changes in doing business and demonstrate accountability to the VBI commitment and stakeholders.

IV. **Constructive and inclusive collaboration with stakeholders**
The active participation of stakeholders ensures that decision-making process under the VBIAF is conducted based on complete and transparent information.

**ESG DISCLOSURE REQUIREMENTS AND TRENDS**

In October 2015, Bursa Malaysia published the so-called Sustainability Amendments to the Main Market and ACE[5] Market Listing Requirements, which relate to sustainability statements in annual reports. Under the Sustainability Amendments, listed issuers are required to include in their annual reports a statement on the management of material economic, environmental, and social risks and opportunities. These statements replaced the previous statement of corporate social responsibility activities and practices that listed issuers were required to disclose. Main Market listed issuers must also report on their governance structure and the scope of the sustainability statement. In September 2022, the Exchange has enhanced the sustainability reporting requirements in the Listing Requirements further to ensure their continued relevance and to propel listed issuers to adopt international best practices.

Issuers listed on the Main Market must now include the following disclosures in their Sustainability Statements:

I. A common set of prescribed sustainability topics and indicators that are considered material for all listed issuers;

II. Climate change-related disclosures that are aligned with the recommendations of the Task Force on Climate-related Financial Disclosures;

III. At least three financial years of data for each reported indicator, corresponding targets (if any) and a summary of such data and corresponding performance targets; and

IV. A statement on whether the Sustainability Statement has been reviewed internally by internal auditors or independently assured.

The sustainability reporting requirements for ACE Market listed corporations have also been strengthened to align with those of the Main Market. In addition, ACE Market listed corporations are now required to disclose a basic plan to transition towards a low carbon economy («transition plan»), with regards to climate change reporting.

5 The ACE («Access, Certainty, Efficiency») Market is a sponsor-driven market designed for companies with high growth prospects. Prior to August 2009, it was known as the MESDAQ Market.

**Case study 1: Allianz: Integrating ESG in insurance and investments – tools and processes**

According to its website, Allianz, a global insurance and financial services company, has implemented a variety of tools and processes to integrate Environmental, Social and Governance (ESG) into its insurance and investment operations.

The company identifies potentially critical transactions in sensitive business areas considered material by Allianz. All potentially sensitive business is screened and assessed for ESG risks.

Through its ESG scoring approach, Allianz investment professionals consistently factor ESG risks and opportunities into their investment decisions. The ESG performance of listed companies is systematically assessed and companies with scores below a certain threshold must be explained or divested by the asset manager. Through systematic engagement with its invested companies, Allianz intends to improve these companies' management of material ESG risks and issues.

For investments, Allianz engages with the bottom 10% of listed assets in its portfolio to understand their business and help them improve their ESG performance. In insurance, Allianz engages in risk dialogues with clients to discuss significant ESG risks. Furthermore, the company strictly prohibits investing in certain sectors such as banned weapons, coal-based business models or sovereign bonds of countries with documented serious human rights violations. Allianz also restricts offering insurance cover for certain business sectors such as controversial weapons and coal-based business models.

Source: https://www.allianz.com

**Case study 2: HSBC: Responsible investment trough ESG integration**

HSBC is one of the largest banking and financial services organisations in the world.

According to HSBC, in order to identify potential risks and opportunities that may not be adequately assessed by the financial markets, it has introduced a multi-layered system that systematically integrates ESG considerations into the entire investment process. This gives them a holistic overview of all the companies they invest in and enables them to make informed and sustainable investment decisions.

HSBC does not knowingly invest in companies associated with banned weapons including anti-personnel mines, cluster munitions, biological weapons, chemical weapons, non-detectable fragments and blinding laser weapons. These exclusions apply to all strategies despite being active, systematic or passive.

The company starts by identifying the most financially impactful E, S and G issues for each sector and proprietary ratings are based on qualitative research and third-party data. Portfolio managers and analysts conduct a thorough assessment of the ESG risks and opportunities associated with their investments.

Active holdings are closely monitored by portfolio managers, analysts and the stewardship team, accompanied by regular meetings with company management. Passive strategies benefit from a thematic exposure overlay. Higher risk issuers trigger the Enhanced Due Diligence (EDD) process. This may result in continuing engagement with the issuer, restricting new purchases or divesting an existing holding.

Source: https://www.assetmanagement.hsbc.com

### GLOBAL TREND TO MAKE ESG DISCLOSURES MANDATORY, WITH SMES OFTEN STILL EXEMPT

According to a PWC survey, two-thirds of institutional investors believe ESG will become an «industry standard» within five years, and many investors have begun to actively allocate capital based on ESG information and ratings.[6] Over the past decade, ESG investing has grown rapidly, with professionally managed portfolios that have integrated ESG assessments already exceeding USD 17.5 trillion globally. According to Morningstar, the number of funds launched globally that incorporate ESG criteria increased from 140 in 2012 to 564 in 2019, but ultimately successful implementation will depend on the ability of ESG funds to generate attractive returns. Early indications are promising: Based on data provided by Refinitiv, the OECD calculated that the 20 % of U.S. companies with the highest ESG ratings generated an average return on equity of 12 % over the 2009–2019 period, while the average return on equity of the 20% of companies with the lowest ratings was only 8.4 %.[7]

To assess a company's ESG dimensions, investors need access to standardized ESG performance data. Commercial data providers offer this information in the form of various ESG data points that are widely used by investors, although there is little clarity and agreement on definitions, including what ratings or data products should measure. In practice, ESG data is not comprehensively available to investors. This could be because the regulations, where they exist, are not very specific about the content of the disclosure, for example unclear or missing quantitative KPIs, or because they are only targeted at a subset of listed companies. Another reason is that ESG rating agencies usually target a selected universe of mostly large companies and only collect data for these companies.

In September 2021, the International Platform on Sustainable Finance (IPSF) published a report on the state and trends of ESG disclosure policy measures across IPSF jurisdictions, Brazil, and the US. Through a descriptive empirical analysis using company-level data from Refinitiv[8], the availability of the variables of the ESG Score and data related to direct $CO_2$ emissions was assessed in the report.

6 https://www.pwc.com/us/en/industries/financial-services/library/reporting-and-esg-story.html
7 Boffo, R., and R. Patalano (2020), «ESG Investing: Practices, Progress and Challenges», OECD Paris, www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf
8 Refinitiv, an LSEG (London Stock Exchange Group) business, is one of the world's largest providers of financial markets data and infrastructure

The following are the key findings of the report[9]:

– While the landscape of ESG disclosure policy measures is diverse, there is a global trend towards mandatory disclosure.
– There are major gaps that need to be addressed to enable the pricing-in of sustainability impacts and risks in investing and enable such decisions take account of entity's impacts on the society and the environment: the comparability, accessibility, and assurance of the disclosed information.
– Entity-level ESG disclosure policy measures, such as regulations for insurance companies or banks, are very widely implemented, whilst regulations targeting financial products and financial services are still in their infancy in most jurisdictions.
– Small- and medium-sized enterprises are mostly exempted from mandatory ESG disclosures, despite SMEs represent the bulk of economic activity in various sectors and the corresponding sustainability risks and impacts; most regulations focus on listed companies.

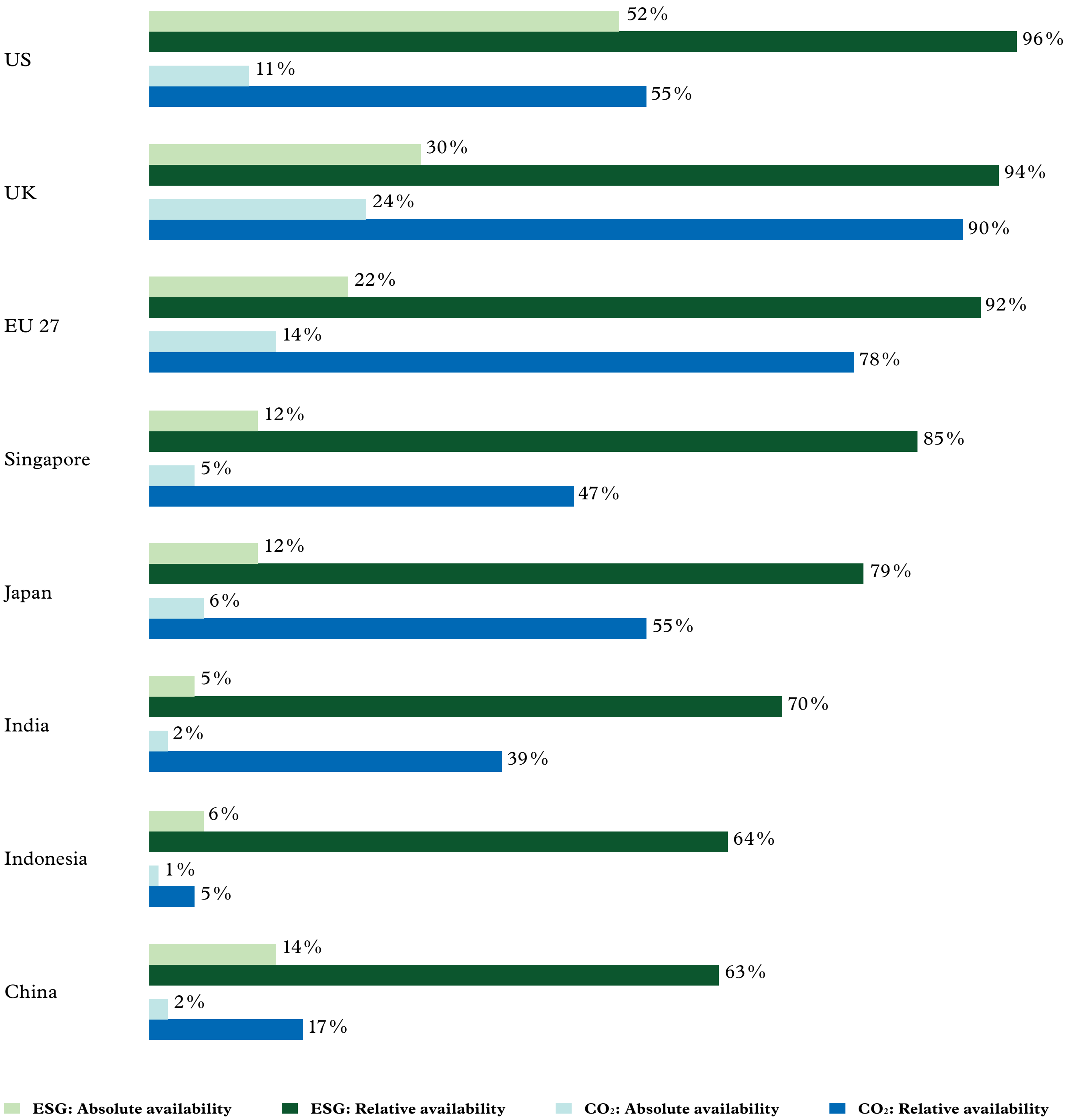
### INVESTORS OFTEN RELY ON ESG SCORES AS A FIRST OVERVIEW, DIRECT $CO_2$ EMISSIONS USED AS AN INDICATOR FOR THE CORPORATE CLIMATE FOOTPRINT

The definition of materiality, mandatory reporting requirements, scope and content of most disclosure guidelines are not yet adequate to the global sustainability challenges. In particular, specific climate-related disclosures are still voluntary in most jurisdictions. As a consequence, investors often rely on so-called ESG scores to get a first overview, while $CO_2$ emissions are the most important indicator of a company's climate footprint.

Chart 11 shows the absolute and relative availability of the two data points. The former refers to the number of listed national companies, while the latter describes for how much of the market capitalization the respective data point is available. Investors often rely on ESG scores as a first overview, whereas $CO_2$ emissions are the most important indicator for a corporate climate footprint. The chart presents both, the absolute and relative availability of data points. The former relates to the number of listed national firms, whereas the latter describes for how much of the market capitalization the respective data point is available.

9 IPSF (2021): The state and trends of ESG disclosure policy measures across IPSF jurisdictions, Brazil, and the US

**Chart 11: ESG data availability across IPSF[10] jurisdictions (ranked by relative availability of ESG data)**




10 International Platform on Sustainable Finance

The ESG score shown in the chart is based on ten categories – three for Environmental, four for Social and three for Governance: Emission, innovation, resource use (environmental), community, human rights, product responsibility, workforce (social) Corporate Social Responsibility (CSR) strategy, management and shareholders (governance). Within these categories, there are a total of 186 individual data points. All are weighted and result into a score that ranges between zero and 100. In general, data availability for the ESG score is significantly higher across the board since it is an aggregated figure (and not every indicator is needed). In terms of market capitalization - an indicator not necessarily correlated with corporates' environmental footprints – a high share is covered since ESG rating agencies tend to focus on large companies.

Data on $CO_2$ emissions shown in the chart are direct emissions only, i.e., emissions from company-owned facilities. They can be distinguished from indirect emissions, such as emissions, which are (1) indirect emissions from the generation of purchased energy, and (2) emissions, which are all indirect emissions not yet included and occurring in the value chain of the reporting company, including both upstream and downstream emissions.

# Survey results

## AWARENESS AND SIGNIFICANCE OF THE PARIS AGREEMENT

**Chart 12: Are you aware of the Paris Agreement and the implications for your home country / economy?**


There is a high consensus among Malaysia's insurers about the importance and relevance of ESG for the industry. Pressure is coming from several ends: firstly, with the impact from climate change the losses from natural catastrophe events, namely flooding, have been on the rise since years – cumulating in the largest natural disaster Malaysia has experienced thus far, the Great Flood in December 2021. Insurers are thus well aware that they need to tightly manage their natural catastrophe exposure, in particular as international reinsurance prices for the risk are on the rise as well, while capacity is shrinking and conditions are tightening. Furthermore, insurers recognize that insurability may become an issue when both the frequency and severity of these events increase.

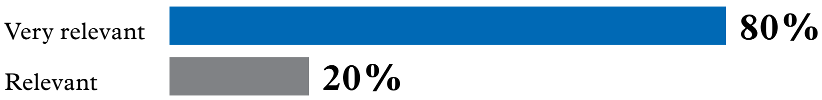
With the mounting natural catastrophes of the past years, Malaysia's wider public and the government also recognize a need for action. While penetration is still low, insuring and transferring the risk to the insurers will not be sufficient to manage the risk. Malaysia – along with all other countries – will have to take measures to avoid or mitigate the catastrophe risk, tackling the causes for climate change, particularly carbon emissions.

When the Malaysian government signed the Paris accord following the COP21 in 2015, it was well aware that to meet its emission targets, it would have to revamp the country's economy, reducing its dependency on fossil fuel for exports and increase its energy efficiency. It thus engaged Bank Negara, the central bank as well as the Kuala Lumpur Stock Exchange (KLSE) to facilitate the change through their licensed companies – the financial services industry as well as the country's leading public listed companies.

With the flooding in December 2021 Malaysia experienced a 1-in-200 year event, which clearly put climate change on top of the agenda of our industry. We need to build on this momentum and drive forward a green agenda which will help to create additional jobs while reducing cost related by our current, more pollutant economic model. At Malaysian Re we have set ourselves ESG targets which we cascaded down from the Board and Top Management to our employees. For our underwriting strategy, we determined green energy targets for risks that we want to cover additionally and for those that we want to decrease. Likewise, we participate and administer commissions and committees to create coverage for green technologies such as the ASEAN Green Energy Pool as well as in building a flood pool to enhance the resilience of the B40 segment of Malaysia's population against catastrophic flood events, like last year.

**Zainudin Ishak, President & CEO, Malaysia Reinsurance Berhad**

**Chart 13: Do you consider the Paris Agreement as relevant for your own business?**




In its role as risk manager and risk carrier, as well as institutional investor, the insurance sector is predestined to play a lead role in this transformation. As ESG assumed top priority for Bank Negara, the supervisor asked its insurers to measure, stress test and report its natural catastrophe risk, namely in light of the mounting impact from climate change. With the Climate Change and Principle based Taxonomy (CCPT), reporting requests on actions taken to combat climate change and recurrent discussions with the insurers, Bank Negara currently defines and specifies its supervisory position and ultimate policy on climate risk and change.

Although that process has not yet been concluded, ESG has assumed top relevance across the sector. Most insurers confirm that they have already started to draw up their own processes how to include ESG in their underwriting and investment strategies as well as in their operations. However, insurers point out that clear measurements and taxonomies still need to be defined. They expect that this process may well take some time to finalize as the introduction of an ESG rating will ultimately result in higher prices and reduced access to insurance funds for some industry players, while others may benefit from lower costs and preferential funding.

Despite the consensus, there are some insurers who are sceptical about the ramification of ESG for the industry. Firstly, strategically the scheme does not affect all players equally. In many cases, Malaysia's insurers are affiliates of global players that outline their ESG strategy at group-level. Exclusions of thermal coal plants are defined globally, just as well as inclusions for certain renewable energy risks. Furthermore, ESG is frequently criticized for setting policies without being legitimized, and some insurers caution to rush ahead and implement actions that might still be subject to change.

**Chart 14: Does your company's current strategic plan already consider the Paris Agreement and its potential implications for your business?**


Malaysian insurers understand the ball is in their court. As one insurer phrased it: «We have the means to bring about change and we should use our influence to push the agenda.» Thus, many have already begun to integrate ESG in their overall strategy, taking a top-down approach, in which many define accountabilities, guidelines and deliverables. More specific, companies frequently stated that they had nominated a designated ESG manager, sometimes called Chief Sustainability Officer, who oversees the implementation of the strategy and defines specific actions to manage the company's own carbon emissions and sets up a reporting process.

Secondly, many insurers try and develop guidelines to categorize their risks and assets in those with a positive or negative impact on their overall ESG performance. Based on these classifications they define a roadmap to either increase, hold or decrease those risks or assets according to their ESG rating. However, these classifications are still challenging as Bank Negara has not yet provided an official taxonomy to categorize risks or assets. In these early stages, most insurers therefore focus on risks and assets where the impact on ESG is undisputed, like for instance thermal coal or wind energy.

The taxonomy is also challenging because risks or assets with a negative ESG impact cannot easily be exchanged against those with a positive rating. Risks or assets with a positive or negative rating are not available in sufficient quantity or quality. Particularly on the asset side, insurers complain that for instance green bonds are available in smaller quantities than needed and also provide different return profiles or volatilities than conventional bonds. In light of current uncertainties how to categorize certain risks in terms of their ESG profile, insurers nevertheless have started to collect information on the ESG characteristics of risks from their clients and possibly initiated discussions on how profiles could be improved.

Furthermore, where possible, Malaysian insurers go ahead and start to define deliverables or KPI's for management and employees. These include certain targets for the operation of a firm in terms of its own carbon emissions, such as less travel, less waste production or a more economical energy consumption. However, this also includes measures on how to improve the transparency of the risk or asset portfolio and how to improve its ESG profile.

ESG is high on the agenda of policymakers who committed to the Paris accord and as such Bank Negara is currently in the process of implementing a framework for Malaysian insurers and our industry partners. As a leading institutional investor and risk carrier, the insurance sector is in a strong position to play a leading role in the decarbonization of our economy. However, we should expect this process to take several years as we define the rules and regulations for this transition.

**Antony Lee, Chairman of the board of PIAM**

**Chart 15: Did your company already implement processes and reporting procedures related to the adherence to environmental standards**

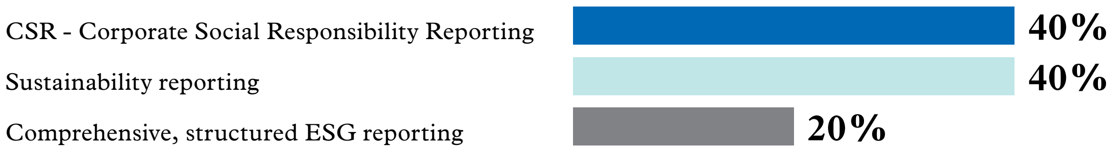

Insurers are thus installing processes and procedures to manage their ESG profile. Among the insurers operating internationally, some of these components, however, are implemented at group or regional level. At the national level the affiliate company will work with Bank Negara to assure that guidelines developed at group level will be recognized in Malaysia.

Insurers first focus on the strategies to manage their ESG rating. While they thus define the procedures needed to classify as well as include or exclude, increase, hold or decrease certain risks, they nevertheless bemoan the lack of an official taxonomy coming from the regulator to assure consistency.

Many expect that this process might take years, partly due to its complexity, but also because of its sensitivity for those sectors that might struggle to maintain access to insurance cover in the future. Nevertheless, insurers emphasize that it is not only them who are advancing. Their corporate clients are also looking at their performance and again their suppliers and clients to improve their ESG profile.

Companies already plan to reflect ESG targets in the annual reports to flag their commitment to contribute to a less carbon intensive economy. However, a specific ESG reporting has not been defined yet.

**Chart 16: Which other measures, such as ESG, CSR and/or sustainability reporting, are currently in place in your company?**




The practice of socially responsible investing dates back to the 1960s, when investors began to single out certain stocks or industries based on their business activities, namely due to their involvement with the South African apartheid regime. This differentiation of companies based on certain ethical or value considerations triggered over time corporate efforts to demonstrate good corporate citizenship. This was reflected in the disclosure of sustainability or CSR reports and, more recently, ESG reporting which has expanded to reflect financial significance as well – encouraged by the importance placed on «ESG compliant» business practices by investors, rating agencies and regulators.

Many Malaysian insurers have established value-based reporting on sustainability or corporate social responsibility – either at national or group level. This reporting – mostly annual – has been encouraged by regulators a well and will be complemented or substituted by a dedicated ESG reporting, although some insurers are considering integrating it into the annual report to give it even more weight.

Insurers in Malaysia are aware of some of the agreements reached at COP 26. Bank Negara proactively raises these issue by requesting that insurers factor in the impact of climate change and natural catastrophes on their portfolio. Insurers are beginning to think about developing strategies on ESG, defining risk categories and eventually thinking about introducing an ESG score for policyholders. There is also added attention being paid to reinsurer's ESG statements. The implementation of these processes are expected to take some time, but eventually risks with a negative ESG score will find it more difficult to secure cover.

**Faris Davidson, Managing Director, Gallagher Re**

## IMPACT ON OWN OPERATIONS

### A. INVESTMENT

**Chart 17: Does your company have an investment strategy in place to facilitate decarbonisation?**


Malaysia's insurers are not yet in a position to follow a set strategy based on ESG criteria for their investment portfolio. Those companies that are most advanced are international companies that take these decisions at group level, where the breadth of the portfolio offers a broader range of decisions than at the level of the national affiliate. Within Malaysia, however, the insurers struggle with the limited investment opportunities available to them. Firstly, the share of equities held by insurers is small. They are mostly invested in sovereign bonds, which – according to interviewees – have a negative ESG profile reflecting the country's bias as a fossil fuel exporter and consumer. Furthermore, the supply of green bonds or equities available is not as extensive and diversified as would be required for a substantial shift from conventional assets to those with a positive ESG profile.

In addition, Bank Negara has not yet defined investment classes according to ESG criteria. The regulator encourages investments into «green» assets and insurers will report on their quarterly activities regarding climate change risks, but ultimately the regulator does not mandate certain investments. The insurers are thus mainly in the process to define key parameters how to classify or categorize their investments according to an ESG rating or grading. In a second step they will decide on the roadmap of how to reduce or increase investments with either a negative or positive ESG rating and how to phase out investments for instance related to coal exploration or coal fired energy production and how to phase in others, such as green bonds or equities related to renewable energy production. And finally, they will need to discern the implications that such a repositioning of their investment strategy will have on the portfolio's risk profile, volatility or returns.

**What are the opportunities and challenges for your company related to investments in climate resilient and decarbonised critical infrastructure?**

Fossil fuels still play a key role in Malaysia's economy. It thus comes at no surprise that a decarbonization of the economy confronts the country's insurers with a significant number of challenges that for many still outweigh the opportunities.

On the upside, insurers expect green or sustainable investments to provide stable and robust returns, based on the assumption that they will be investing in long-terms assets geared towards generating predictable returns. In terms of renewable energy, risks and volatility might be higher, but therefore return expectations are also more ambitious, reflecting the large ramp-up investments needed to establish and expand the sector in Malaysia.

However, as already stated, investment opportunities remain scarce, and their performance is still largely unclear. Insurers also worry about the transition, as they consider to phase out of established investments with a negative ESG rating and to move into new ones with a positive rating. Finally, where investments are managed on a global basis, insurers aim to negotiate with Bank Negara, to ensure that the guidelines implemented at group level are deemed equivalent to the measures eventually required by Malaysia's supervisory authority.

## B. UNDERWRITING

**Chart 18: What kind of underwriting measures, such as capacity allocation, did you already implement to facilitate decarbonisation/the implementation of ESG measures? (multiple answers possible)**

Malaysia's insurers are equally advanced on the liability side as on the asset side in implementing a strategy which reflects ESG requirements. Since a taxonomy or principles for a consistent categorization of underwriting risks has not yet been issued, insurers have first defined exclusions from their portfolio, as these are the most obvious decisions. Most insurers agree that the insurance of coal fired energy plants, artic drilling or thermal coal will steadily be phased out. However, as most insurers pointed out, this will only apply to new risks, not established ones.

As one insurer put it, «old policies will be continued, until the government has established a new power plant infrastructure. The aim is to continue supporting the transition of the Malaysian energy sector and not to disrupt supply by pulling existing coverage.» Some set themselves a target to reduce their thermal coal exposure steadily by 5 % per year. Likewise, they also aim to increase their exposure to renewable energy risks by a fixed percentage per year.

Although insurers emphasize that they must balance their environmental with their economic responsibilities and that they must assure a smooth functioning of the economies they are embedded in. Thus, if the economy relies on the insurers to provide protection for an economically important asset, the insurers will not refuse to underwrite the risk. In addition, the country's insurers stressed that Malaysia is an emerging market economy dependent on energy-intensive manufacturing processes. Insurers will thus continue to underwrite risks which are the basis of the country's growth and prosperity. They will also assure that industries with a high number of employees will see no shortage in access to capacity.

In line with regulatory requirements, insurers are stress testing how their underwriting portfolio will respond to large natural catastrophe events, minimizing the risk of accumulations. The results of these tests also feed into scoring mechanisms that insurers develop to categorize risks according to ESG criteria and that will serve to assure a smooth transition in a competitive market environment.

Insurers are also keen to record efforts of clients to improve their ESG rating. They are working with their clients to develop a joint understanding of the ESG profile of risks, identify the largest exposures and determine a roadmap how to steadily transition the clients' portfolio towards a less carbon intensive business model.

Despite all efforts to reduce exposure to risk with negative ESG characteristics, insurers also struggle on the liability side on how to build up a portfolio of ESG positive risks. Largely, industries related to renewable energy are still in their infancy in Malaysia. Data is still scarce and it can be thus challenging to assess risks. This is equally true for wind, solar or hydrogen power where manufacturing facilities, power plants and connectivity grids still must be established. Finally in the mass market, few electric cars have been licensed yet in Malaysia. Thus far, insurers agree to treat them like conventional cars, although their risk profile is considered higher by some insurers due to higher repair costs and the challenge that a burning lithium battery may pose.

In April 2021, Bank Negara has laid out a Principle-based taxonomy for the financial sector, which provides us with a clear direction on how to measure and act on the impact of climate change. For ESG these parameters have to be translated into behavioural change for both our underwriting and investment strategies. We now must define consistent categories for economic activities, which we test against our portfolios, assessing their impacts on our underwriting and investment performance with the aim to promote the transition to a low-carbon economy.

**Chua Seck Guan, CEO, MSIG Insurance (Malaysia) Bhd**

**Chart 19: Did your reinsurers discuss the issue of decarbonisation / ESG with you? If yes: Which were the most critical elements / focus areas?**


In the relationship between Malaysian insurers and their reinsurers, ESG is not yet a major concern. Firstly, both parties are waiting for formal guidelines from Bank Negara before incorporating ESG into the conditions of their programmes. Discussions, however, have started as in particular the international reinsurers are often more advanced in the incorporation of ESG into their strategies and operations.

The main interest is on the underwriting side, where both insurers and reinsurers are trying to enhance the transparency on programmes, particularly in treaties which cut across a multitude of risks and corporate clients. Here both sides discuss potential exclusions or inclusions as well as the transition to enhance the ESG profile of a programme. Again, of foremost interest are programmes which involve risks from coal or oil and gas related energy production or exploration. Interest is mutual as also the cedents want to know what their reinsurers do to enhance their profile. No requests have yet been recorded from retrocession providers.

**Chart 20: Did your reinsurers already start to impose tighter terms and conditions, such as exclusions or special acceptances, because of ESG / carbon footprint?**


Interviewees, however, pointed out that although ESG guidelines are still in an early phase of development, discussions and measures are far more advanced in improving the management of natural catastrophe risk, especially since the last flood event in Malaysia in December 2021. Natural catastrophe capacity has tightened as on a global scale large loss events as well as on a regional scale secondary perils have been on a rise, reflecting the impact of climate change. As a result, Malaysian insurers have been restructuring their own natural catastrophe – namely flood – risk, but they also encounter higher prices and tighter terms and conditions from their reinsurers.

**Chart 21: Are you asking your clients to report/disclose decarbonisation/ESG related data, such as exposure to certain industries or their investments?**


Likewise, most Malaysian insurers are keen to define their own processes and criteria first before asking «too many questions». Besides, across the value chain – from the client through to the reinsurers – the parties agree that the repositioning of the economy to a less carbon intensive model is a joint effort. It does not just start with the primary insurer, nor its corporate client, who in turn will also discuss with its clients and suppliers about their ESG measures.

**Chart 22: Are you already disclosing/reporting decarbonisation/ESG data?**

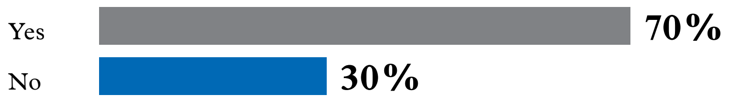

For many of the Malaysian insurers, the scope and pace of ESG disclosure is largely determined by Bank Negara. In December 2019 the Central Bank first issued its discussion paper on Climate Change and Principle-based Taxonomy (CCPT), to facilitate financial institutions in assessing and classifying economic activities that contribute to climate change mitigation and adaptation.

This was followed up with the Climate Change and Principle based Taxonomy guidance, issued in April 2021, which introduced a classification of risks into certain transitory categories and aimed to provide greater clarity on how to assess business operations according to its impact on pollution, biodiversity and resource efficiency.

Based on these guidelines some insurers prepare to disclose their environmental impact in their forthcoming annual reports, some as early as 2022, others as of 2023. Insurers are also waiting for Bank Negara to move forward and put into action the recommendations for climate-related disclosure, which are developed by the Task Force on Climate-related Financial Disclosures (TCFD).

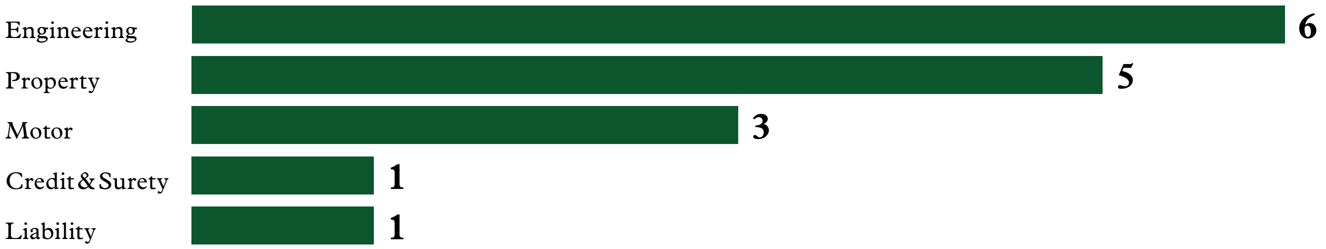
## C. NEW PRODUCT DEVELOPMENT

**Chart 23: Did you already start to develop new products related to climate risk adaptation and mitigation or environmental risks?**




Insurers are preparing to take advantage of the enhanced focus on renewables and the electrification of the mobility sector. A majority regards the emerging business opportunities as huge. However, not all products to be deployed are new, but might need solely a refinement to accommodate for the requirements to cover solar, hydro and wind energy risks. One of the key challenges though is still a lack in data and experience with the risks. While in some cases this may result in tighter limits or even exclusions as insurers decide to tread cautiously, the majority is moving forward covering risks related to renewables.

**Chart 24: If yes, in which lines of business? (multiple answers possible)**



The largest lines of business are property and engineering, which include the cover for solar, hydro and wind farms, but also the photovoltaic (PV) panel installation that house owners may place of their rooftops to reduce their electricity bills. Experience in particular with PV plants is still limited and insurers pointed out that initial experience indicates high loss ratios and thus insurers need to improve pricing. In addition, insurers expect that with the increased use of renewable energy, manufacturing facilities to supply the machinery and technology for the installations will be emerging in Malaysia, which will require additional insurance coverage.

The third largest line is expected to become the motor insurance for electric vehicles. Thus far, insurers provide cover for the few electric cars yet on Malaysia's roads on the basis of the conventional motor policies which are still tariff-based, although some noticed higher costs for repair (as in case of damage or failure, larger units are exchanged) and also a slightly higher fire risk as a burning lithium battery is difficult to extinguish.

Given the uncertainties around renewable products or power plants, insurers collaborate closely with their reinsurers for product development and pricing. For instance, discussions are ongoing to form pools which would provide cover for green energy across the ASEAN region. Parametric solutions gain in importance as for instance hail or windstorms will have a substantial impact on PV panels. In addition, weather derivatives are in demand to cover the risk that PV panels produce less energy in a given period than envisioned.

**Chart 25: Do you see a growing demand for such products?**


Nevertheless, demand is expected to grow, as a green infrastructure emerges which includes not only renewable energy plants but also the power grid as well as for instance charging facilities for electric vehicles. Thus far, this infrastructure is still largely built for an economy based on fossil fuel consumption and consequently, prices for renewable energy products still appear high and demand is slow. But Malaysia's insurers also notice the development in other emerging markets in Asia where the share of green energy – for instance solar plants - steadily grows.

## D. REFORM OWN CARBON FOOTPRINT

**What measures has your company in place to reform its own carbon footprint?**

Besides the recomposition of asset and underwriting portfolios to reflect ESG requirements, Malaysia's insurers have also introduced measures to reduce their own carbon footprint. The COVID-19 pandemic has actually already initiated some groundwork that insurers have decided to maintain.

Due to the restrictions on movement and the positive experiences with online conference calls, insurers had already adjusted their travel policies. Although most countries have ceased all travel restrictions, most Malaysian insurers decided to not return to a habit of frequent business trips to visit clients or suppliers.

Similarly, COVID-19 has accelerated the digitization of the insurance sector. As a result, more employees can work at least partially from home, which reduces the daily commutes to the office and enables the company to move to smaller office buildings. Furthermore, the digitization in combination with the introduction of electronic signatures has reduced the amount of paperwork and paper consumption.

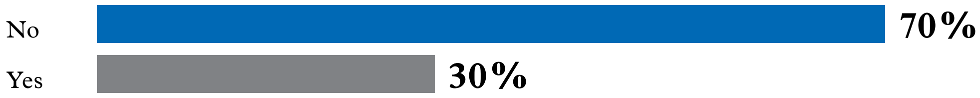
Finally, many companies used the time when their employees had to work from home and renovated their offices or moved to buildings which are more energy efficient. As a result, the ecological footprint of Malaysia's insurers has improved substantially in the COVID-years and the players are committed to continue on that route.

The COVID-19 pandemic delayed the start of infrastructure projects in the region, including in renewable energy and green economy initiatives. Therefore, while we are not yet overwhelmed by demand for cover for renewable energy risks, enormous greenfield opportunities for investments into renewables and green infrastructure are emerging. One example is the Sun Cable project that intends to use a 4,200-kilometer (2,600-mile) high-voltage undersea cable to export power from a giant solar and battery complex in northern Australia to Singapore that is targeting a final investment decision in early 2024. Key markets, like China and India, have committed to build up a whole new infrastructure for renewable energy, from power generation to grids and energy storage. Over time, insurers will have to provide the specialist products to enable this the transition to a less carbon-intensive economy.

**Pavlos Spyropoulos, Regional Managing Director Asia, Tokio Marine Kiln Singapore**

## E. ADVOCACY

**Chart 26: Are you supporting public sector carbon abatement initiatives?**




Most Malaysian insurers do not support public sector carbon abatement programmes. They might engage in some environmental or CSR programmes or work closely with government agencies to reduce systemic risk. However, there are no public programmes on carbon reduction that the insurance industry would engage in.

Rather, those who stated that they engage in public activities to reduce emissions, work closely with Bank Negara to advance the adaptation and implementation of ESG for the Malaysian insurance market. Furthermore, insurers and also reinsurers collaborate closely with the various industry associations at national or regional level to promote the application of ESG.

**Chart 27: Is your regulatory authority actively discussing ESG/decarbonisation objectives and implications with your local industry/your company?**


Malaysia's insurers uniformly agree that Bank Negara is at the forefront of the ESG implementation for the financial services industry and the insurance sector in particular. The Central Bank thereby translates the commitment that the Malaysian government has delivered with the Paris accord in 2015 to the financial services industry as a key change agent for the country's economy.

The Bank, however, is not the sole agent to drive forward the ESG implementation in Malaysia's industry sectors. The Securities Commission of the Kuala Lumpur Stock Exchange, the Bursa Malaysia (KLSE), pursues a similar direction and collaborates closely with Bank Negara, for instance in a joint committee on climate change (JC3).

Despite the activities of the Central Bank and the governmental endorsement, the country's insurers expect the implementation process of ESG to take several years. Although the direction of the Bank is clear, measures are not mandatory yet, but encouraged. Insurers are thus «working hand-in-hand» with the Bank to assume a smooth and swift implementation.

## F. SOCIAL AND GOVERNANCE ASPECTS OF ESG

### How relevant are the «social» aspects of ESG to your company?

The focus of Bank Negara and Malaysia's insurers is on the environmental and climate related aspects of ESG. The social facets of ESG are not yet part of the Central Bank's regulatory efforts, as defined in the Climate Change and Principle-based Taxonomy (CCPT) or the disclosure requirements discussed by the Task Force on Climate-related Financial Disclosures (TCFD).

Nevertheless, social aspects play a key role both in the strategies of the Malaysian insurers as well as from a regulatory standpoint. Since years Bank Negara has encouraged for instance the financial inclusion of the lower income groups of Malaysia's society, the so-called B40 segment, which refers to the lower 40 % income group. It has asked insurers to develop coverage in personal lines to provide access to protection to those who normally can't afford insurance. As a result, insurers have developed products which target particular the lower income bracket of society. Most of these initiatives have been launched independently and well ahead of the more recent discussions on ESG.

Although insurance products for this part of society struggle to overcome challenges in distribution (namely in Malaysia's distribution system heavily dependent on the agent channel), claims payments and affordability. Products named include medical and hospitalization cover as well as vouchers for term life or personal accident products, which have been met with substantial demand.

Following last year's events, insurers consider to team up and to form a dedicated flood pool, that would provide coverage for people who are particularly exposed to these types of natural catastrophes as they live close to river beds or coastal lines which are prone to flooding. They also launched funds to protect children against the consequences of an early death of their parents or provided protection geared particularly at SME clients or even the GIG economy of self-employed workers who live on subsistence. However, insurers also cooperate with the Central Bank and the government to develop products which address systemic risks, namely climate change, to which – according to a study by Bank Negara – close to 25 % of Malaysian insurance and takaful assets are exposed.

The efforts of the Malaysian insurers to improve the inclusion of segments of society which have no access to insurance typically enjoy the full support of parent companies as they will positively impact on their reputation too. However, as our interviewees stated, the motivation for these programs is foremost due to the need to strengthen the resilience of society towards risks that may well derail these parts of society and cause stress and potentially unrest throughout the nation. Thus, neither interests from reinsurers, nor shareholders, investors or group consideration play a substantial role here.

The social aspects of ESG also target the equal treatment of employees or other stakeholders irrespective of gender, religion or origin. Most companies stated that they have programms in place to encourage the career of women in senior management functions. However, even despite these programs, the number of women in top management positions is quite high among some Malaysian insurers. Religion or origin were rarely mentioned as aspects requiring specific attention in Malaysia. However, several companies confirmed that they have whistleblowing mechanisms in place to disclose and follow up on cases of discrimination.

The Malaysian insurance & Takaful industry and Bank Negara Malaysia (BNM) as their regulator have made significant progress in establishing a comprehensive approach to ESG in recent years. For instance, BNM introduced the Climate Change Principle-based Taxonomy (CCPT) in April 2021. During the same year, the Malaysian Takaful Association (MTA) released a 'Value-Based intermediation for Takaful' framework, which has ESG at its core. In addition, the BNM has been advising all the insurance and Takaful companies on improving the management of their climate-related risks as part of their annual composite risk rating. The insurance & Takaful industry is increasingly expected to actively participate in Malaysia's transition towards a less carbon-intensive economy.

**Marcel Omar Papp, Head Retakaful, Swiss Re Asia Pte. Ltd., Malaysia Branch**

**Has ESG had an influence on your «governance» procedures?**

Most Malaysian insurers focus on developing a strategy and integrating ESG into their own operations. Predominately, they have not yet started to report or enhance the transparency of their activities and performance according to ESG criteria to shareholders or the wider public. Some plan to integrate a respective section into their forthcoming annual report and to provide full disclosure as they move forward. And some already discuss with their clients their status on integrating ESG into their operations. However, most companies confirm that they regularly exchange information with Bank Negara on their climate risk exposure and regarding their measures to best contain or manage that risk.

For the most part insurers have not seen a need to tighten their compliance due to ESG. Their activities focus around the environmental aspects of ESG – which are foremost of operational nature – and less on the social or governance part of the framework. Some players integrated ESG targets into the KPIs of the management or even of employees. However, most insurers emphasize that ESG is high on the agenda of their employees and that there is no need to strengthen ESG requirements or to define penalties for non-compliance.

At group level some international insurers stated that they already installed a dedicated ESG officer who oversees their ESG activities. However, since in Malaysia ESG disclosure focuses on climate risk reporting towards Bank Negara, it still remains a matter of regulatory compliance and will thus be foremost handled through the established management levels and channels facing the supervisory authority. Some international insurers remarked that they report their ESG activities towards their parent company to contribute to the overall group disclose on the subject.

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