

PUBLIC RESPONSE PAPER

No. 2/2022

**PRINCIPLES-BASED SUSTAINABLE AND RESPONSIBLE INVESTMENT
TAXONOMY FOR THE MALAYSIAN CAPITAL MARKET**

The Securities Commission Malaysia (SC) is issuing this Public Response Paper in response to the feedback received pursuant to the Public Consultation Paper on the proposed *Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market* dated 17 December 2021.

This Public Response Paper is dated 12 December 2022.

CONTENTS

1.0	Executive Summary	3
2.0	Feedback on Proposals Relating to the Environmental Component	5
3.0	Feedback on Proposals Relating to the Principles for Financing a Credible Transition	9
4.0	Feedback on Proposals Relating to the Social Component	12
5.0	Feedback on Proposals Relating to the Sustainability Component	15
6.0	Abbreviations	16

1.0 EXECUTIVE SUMMARY

- 1.1 On 17 December 2021, the SC issued the *Public Consultation Paper No.1/2021 on the Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market* (Consultation Paper).
- 1.2 The proposed *Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market* (Principles-Based SRI Taxonomy) seeks to enable capital market participants to identify economic activities that are aligned with environmental, social and sustainability objectives. This would facilitate more informed and efficient decision-making for fundraising and investment, thereby accelerating the development of the SRI asset class and promoting greater awareness and adoption of sustainability practices within corporate Malaysia.
- 1.3 The Consultation Paper was open for public feedback for three and a half months, from 17 December 2021 to 31 March 2022, although the SC continued to receive feedback after the closing date due to requests.
- 1.4 The SC received feedback from a wide range of respondents, comprising asset and fund management companies, asset owners, investment banks, financial institutions, self-regulatory organisations, industry groups and associations, ministries, government agencies, auditors, consultants, sustainable finance specialists and technical experts, rating agencies as well as other stakeholders.
- 1.5 In addition to written feedback submitted through the public consultation process, the SC had a series of one-to-one engagements with selected stakeholders to solicit and discuss feedback on the proposed Principles-Based SRI Taxonomy. These stakeholders comprise but were not limited to relevant government ministries and agencies, investment and asset management companies, asset owners and institutional investors, non-governmental organisations, as well as expert individuals, to capture diverse perspectives in the development of the SRI Taxonomy.
- 1.6 The SC would like to thank all respondents for their valuable and constructive feedback and suggestions.
- 1.7 Overall, the feedback received were supportive of the proposed objectives and components of the Principles-Based SRI Taxonomy. Several components of the Principles-Based SRI Taxonomy have been further refined based on the feedback received.

**Principles-Based SRI Taxonomy
Public Response Paper**

- 1.8 Key feedback from respondents¹ on the proposals, together with the SC's responses, are presented in the following sections. This Public Response Paper should be read together with the Consultation Paper.

¹ Not all respondents provided feedback to all the proposals, and references to respondents in the Public Response Paper shall refer to respondents that have provided adequate response to the respective proposals.

2.0 FEEDBACK ON PROPOSALS RELATING TO THE ENVIRONMENTAL COMPONENT

2.1 Respondents were asked to provide their comments on the following questions:

Question 1 : Do you agree with the proposed environmental objectives for the Principles-Based SRI Taxonomy? Please provide specific reasons for your views.

Question 2 : Do you have any suggestions to enhance the environmental objectives of the Principles-Based SRI Taxonomy? Please support your suggestions with clear justifications, examples and accompanying illustrations.

Public comments

2.2 A vast majority of the respondents agreed to the proposed environmental objectives of the Principles-Based SRI Taxonomy.

2.3 Several respondents highlighted the need to emphasise and illustrate the alignment of the Principles-Based SRI Taxonomy's environmental objectives with other relevant taxonomies.

2.4 Several feedback also emphasised the need to integrate social considerations or minimum social safeguards into the environmental component, as part of the Do No Significant Harm (DNSH) criteria of the environmental objectives.

The SC's response

2.5 One of the key considerations in developing the Principles-Based SRI Taxonomy is to ensure its alignment with major taxonomies *vis-à-vis* national, regional and international domains, as well as widely accepted recommendations for sustainable finance taxonomies. While it is important to ensure that the Principles-Based SRI Taxonomy is consistent and compatible with other relevant taxonomies to enable interoperability, the state of readiness of the wider Malaysian capital market should be regarded, as the capital market constituents are at different stages of their sustainability journey. As stated in the Consultation Paper, the Principles-Based SRI Taxonomy is aligned with Bank Negara Malaysia's *Climate Change and Principle-based Taxonomy* (CCPT) and the Foundation Framework of the ASEAN Taxonomy Board's *ASEAN Taxonomy for Sustainable Finance Version 1* (ASEAN Taxonomy), and a mapping of the environmental components of these taxonomies is included in the Principles-Based SRI Taxonomy to demonstrate the alignment.

**Principles-Based SRI Taxonomy
Public Response Paper**

- 2.6 The Principles-Based SRI Taxonomy has introduced the minimum safeguards criteria, in addition to assessing the DNSH criteria of the economic activities based on the environmental objectives. As a minimum safeguard, economic activities seeking alignment with the environmental component of the Principles-Based SRI Taxonomy should ensure compliance with all laws and legislative requirements relating to environmental and social considerations applicable in Malaysia. Similarly, the minimum safeguards criteria are also introduced for the social objectives of the Principles-Based SRI Taxonomy.

Question 3 : The proposed broad categories of green, amber and red are intended to provide an illustrative guidance on how economic activities can be classified in accordance with their respective contributions to the environmental objectives, on a qualitative basis.

Given that this is a principles-based guidance, these broad categories are not definitive or prescriptive in nature nor does it provide guidance for a quantitative assessment. Therefore, a company should perform additional technical assessments on its economic activity to validate its specific contributions towards the environmental objectives.

(a) Do you agree with the proposed broad categories of green, amber and red to serve as guidance on the qualitative assessment criteria in the classification of economic activities?

(b) Does the proposed explanation set out in paragraph 3.22 on the broad categories of green, amber and red provide sufficient broad-based guidance?

Please provide specific reasons for your views.

Question 4 : Do you have any suggestions to enhance the classification of economic activities? Please support your suggestions with clear justifications, examples and accompanying illustrations.

Public comments

- 2.7 Majority of the respondents agreed with the proposed decision tree to provide an illustration on how economic activities can be classified based on the environmental objectives. However, several respondents highlighted the need to provide greater clarity on the definitions of the various terms and components introduced in the decision tree i.e. substantially contribute, DNSH, remedial efforts. In addition to this,

**Principles-Based SRI Taxonomy
Public Response Paper**

there was also feedback on the need to incorporate DNSH for the assessment criteria on the right side of the decision tree.

- 2.8 Several respondents sought greater clarity on the tiers of assessment for the decision tree, and whether the assessment of the decision tree should only be applicable to economic activities rather than at the company level.
- 2.9 In determining the eligibility of economic activities, a few respondents also raised the need for more granular guidance, i.e. to provide a list of economic activities, which could be in the form of sector or industry classification, to assist users of the Principles-Based SRI Taxonomy in undertaking the decision tree assessment.
- 2.10 Respondents also highlighted that the term 'remedial efforts to transition' used in the Consultation Paper may be restricted to climate change and should be amended to address the harm caused by an economic activity, and thus more relevant for all four environmental objectives.

The SC's response

- 2.11 Greater clarity on the definitions of the various terms and components of the decision tree is provided in the Principles-Based SRI Taxonomy. In addition to this, the decision tree is enhanced by embedding the DNSH criteria in the right side of the decision tree, to ensure consistency in the tiers of assessment. With regards to the applicability of the decision tree, amendments are also made to provide clarity that the decision tree assessments are to be done at the economic activity level.
- 2.12 The Principles-Based SRI Taxonomy provides qualitative assessment criteria in the classification of economic activities that contribute to the environmental objectives. As it is principles-based, it may also be applied at the project, asset, entity or portfolio level.
- 2.13 The term 'remedial efforts to transition' in the Consultation Paper is amended to 'remedial efforts to mitigate harm' to link the remedial efforts to address the harm caused by an economic activity, while also allowing for application across all four environmental objectives, as the scope of the four environmental objectives goes beyond climate change transition. In addition to this, to guide users of the Principles-Based SRI Taxonomy with the assessment on the environmental component, guiding questions are provided in the appendix to the Principles-Based SRI Taxonomy.
- 2.14 The decision tree is an illustrative guidance to facilitate users of the Principles-Based SRI Taxonomy in assessing and classifying the respective economic activities based on the environmental objectives. With regards to the suggestion for more granular guidance on the decision tree for sector or industry classification, the approach taken is for the decision tree to be sector agnostic.

- 2.15 The enhanced decision tree also provides more comprehensive classification where economic activities that do not contribute to any environmental objectives but DNSH are also classified under the amber category. While these economic activities are not the focus areas of the Principles-Based SRI Taxonomy, entities carrying out the economic activities are encouraged to identify opportunities to potentially contribute to any of the environmental objectives.

3.0 FEEDBACK ON PROPOSALS RELATING TO THE PRINCIPLES FOR FINANCING A CREDIBLE TRANSITION

3.1 Respondents were asked to provide their comments on the following questions:

Question 5	: Do you agree with the proposed principles for financing a credible transition? Please provide specific reasons for your views.
Question 6	: In relation to paragraph 4.6 on the company's implementation plans: a) Do you agree with the proposed items set out in this paragraph? b) Are these proposed items adequate to provide guidance in promoting transparency on the company's implementation plans to achieve its science-based targets? c) Do you have any suggestions to enhance paragraph 4.6 including examples of credible KPIs? Please provide specific reasons for your views.
Question 7	: Just transition is a key pillar of an effective and meaningful climate transition that minimises social risks and enhances social opportunities for the wider stakeholders, including employees, consumers and other social stakeholders. In this regard, the Principles-Based SRI Taxonomy intends to support a just transition from the Malaysian capital market's perspective in facilitating investments towards just transition-aligned activities. a) Do you agree with the proposed paragraph 4.6 (f) that the company should be encouraged to consider how its transition strategy supports a just transition? b) Do you have any suggestions on the broad-based guiding principles for Malaysian capital market constituents to support a just transition? Please provide specific reasons for your views and support your suggestions with clear justifications, examples and accompanying illustrations.
Question 8	: Do you agree with the recommendation to appoint an external review provider to review or verify the credibility of the company's transition strategy, as well as the company's progress in meeting the science-based targets on a yearly-basis? Please provide specific reasons for your views.
Question 9	: Do you agree that the proposed Chapter 4 could facilitate the development of transition finance within the Malaysian capital

market and provide guidance to companies in establishing a credible transition framework? Please provide specific reasons for your views.

Question 10 : Do you have any suggestions to enhance the proposed principles on financing a credible transition? Please support your suggestions with clear justifications, examples and accompanying illustrations.

Public comments

- 3.2 While several respondents agreed with the proposed principles for financing a credible transition to be included in the Principles-Based SRI Taxonomy, a number of respondents also questioned the relevance of this chapter as the proposed principles may be too prescriptive in providing the guidance to entities in developing their transition plans.
- 3.3 Other common feedback raised by the respondents include the challenge in distinguishing between remedial efforts and credible transition.
- 3.4 For greater clarity, several respondents also suggested the need to align the proposed principles with existing transition principles issued by globally recognised institutions i.e. Science Based Targets Initiative (SBTI), Climate Bonds Initiative (CBI), or International Capital Market Association (ICMA), as well as to provide more granular details on the transition pathways as well as relevant thresholds to assist entities in developing a transition plan.

The SC's response

- 3.5 The SC agrees that while the proposed chapter on financing a credible transition would be useful to assist users in developing their internal transition finance framework, it may be too prescriptive and cause confusion on the application of the Principles-Based SRI Taxonomy. Hence, the principles on facilitating a credible transition chapter has been moved to the appendix of the Principles-Based SRI Taxonomy. Users who want to develop their internal transition finance frameworks may refer to these principles as a guide to ensure a credible and transparent process in establishing their transition pathways.
- 3.6 While the SC recognises the importance of ensuring alignment with globally recognised transition principles, as well as the need for more granular details on the transition pathways and relevant thresholds, at the current juncture, the Principles-Based SRI Taxonomy does not set sectoral-based quantitative thresholds or targets. However, future iterations of the taxonomy may provide more granular guidance, including quantitative thresholds for the relevant economic activities.

4.0 FEEDBACK ON PROPOSALS RELATING TO THE SOCIAL COMPONENT

4.1 Respondents were asked to provide their comments on the following questions:

Question 11 : Do you agree with the proposed social objectives for the Principles-Based SRI Taxonomy? Please provide specific reasons for your views.

Question 12 : Do you agree that companies should be encouraged to align their business strategies and practices with globally accepted social principles and standards? Please provide specific reasons for your views.

Question 13 : Do you agree with the proposed paragraph 5.6 that companies, which already provide **inherent social benefits** to promote overall social benefits and well-being, should be encouraged to consider **additional social benefits** from providing such goods and/or services?
Please provide specific reasons for your views.

Question 14 : Do you agree with the proposed guidance on assessing these companies' contribution towards the social objective to promote overall social benefits and well-being?
Please provide specific reasons for your views.

Question 15 : Do you have any suggestions to enhance the examples of economic activities to provide clearer illustration of the social objectives?

Question 16 : For the social objective on enhanced conduct towards stakeholders, do you agree that the company should conduct relevant social due diligence to determine its baseline contribution towards managing specific social risks and opportunities? Please provide specific reasons for your views.

Question 17 : For the social objective on enhanced conduct towards stakeholders, do you agree that the company's conduct and practices across its value chain should be assessed on how the company demonstrates positive social outcomes which are clear and measurable as a result of its enhanced conduct and practices?
These positive social outcomes should be assessed in terms of scale, depth and duration.
Please provide specific reasons for your views.

Question 18 : The social component has two social objectives, one of which is **activity-based** (promote overall social benefits and well-being) and the other objective is **entity-based** as it applies to a company's conduct (enhanced conduct towards stakeholders).

What are your views on the application of these two social objectives?

Please provide specific reasons for your views.

Question 19 : Do you have any suggestions to enhance the social component of the Principles-Based SRI Taxonomy? Please support your suggestions with clear justifications, examples and accompanying illustrations.

Public comments

- 4.2 A vast majority of the respondents agreed with the proposed social objectives for the Principles-Based SRI Taxonomy. However, there were also concerns raised on the readiness of introducing a social taxonomy and whether the Principles-Based SRI Taxonomy should be focusing only on the environmental component.
- 4.3 There were also feedback provided on the need to standardise the approach for the social objectives with the approach for the environmental objectives, whether these social objectives are activity-based or entity-based. In addition, several respondents commented on whether the social objectives should be kept broad-based or more targeted to address social concerns which are more relevant to Malaysia.
- 4.4 Several respondents also sought more guidance on the assessment of the fulfilment or departure from the social objectives, as well as greater clarity on what constitutes as additional social benefits.
- 4.5 While companies should conduct relevant social due diligence on economic activities to meet the social objectives, some respondents went a step further to suggest that an independent reviewer should perform this role instead, to provide clarity and confidence to capital market constituents on the achievements of social objectives.

The SC's response

- 4.6 The SC took note of the challenges and the uncertainty in defining social expectations given the lack of global developments surrounding social taxonomies. Nevertheless, the social component of the Principles-Based SRI Taxonomy is intended to be aligned with the SDGs and Malaysia's sustainability aspirations.

Principles-Based SRI Taxonomy
Public Response Paper

- 4.7 The social objectives of the Principles-Based SRI Taxonomy have been refined to be geared towards a stakeholder-centric approach i.e. enhanced conduct towards workers; enhanced conduct towards consumers and end-users; and enhanced conduct towards affected communities and wider society. This is to ensure all aspects of an economic activity's impact on people affected by that activity would be taken into consideration in the assessment of the social objectives, as well as to enable the Principles-Based SRI Taxonomy to specify the desired social outcomes and incorporation of Malaysia's sustainability aspirations, where applicable, for each of the stakeholder group. The stakeholder-centric approach is also aligned with the recommendations by the EU Platform on Sustainable Finance on the EU's Social Taxonomy.
- 4.8 In addition, the social component of the Principles-Based SRI Taxonomy aims to assist users in assessing economic activities' degree of contribution to the social objectives to enable differentiation between inherent social benefits and additional social contributions. Additional guidance is also provided in the Principles-Based SRI Taxonomy on what constitutes as inherent social benefits and enabling activities.
- 4.9 As this is a principles-based SRI Taxonomy, the assessment on compliance with the social component of the SRI Taxonomy can also be conducted at the level of the entity which is carrying out the economic activity.
- 4.10 Similar to the environmental component, the minimum safeguard criteria are also embedded in the social component of the Principles-Based SRI Taxonomy, in addition to assessing the DNSH criteria of the economic activities based on the social objectives. As a minimum safeguard, economic activities seeking alignment with the social component of the Principles-Based SRI Taxonomy should ensure compliance with all laws and legislative requirements relating to environmental and social considerations applicable in Malaysia.
- 4.11 While the Principles-Based SRI Taxonomy is sector agnostic, an enhanced assessment table is provided in the appendix to provide further guidance on the examples of economic activities under several sectors and how these activities could be considered to comply with the social objectives' minimum safeguards and DNSH criteria, as well as deemed to be substantially contributing towards the respective social objectives.
- 4.12 An independent reviewer is useful to provide credibility to user's alignment with the social component of the Principles-Based SRI Taxonomy. However, given the nascent development of taxonomies globally, and the voluntary application of the Principles-Based SRI Taxonomy, the SC is not mandating such requirements at this stage.

5.0 FEEDBACK ON PROPOSALS RELATING TO THE SUSTAINABILITY COMPONENT

5.1 Respondents were asked to provide their comments on the following questions:

Question 20 : Do you agree that a company should comply with Chapters 3 and 5 of the SRI Taxonomy in order to assess whether its economic activity can be deemed as sustainable? Please provide specific reasons for your views.

Question 21 : What are your views on the sustainability component of the Principles-Based SRI Taxonomy?
Please provide specific reasons for your views.

Question 22 : Do you have any suggestions to enhance the sustainability component of the Principles-Based SRI Taxonomy? Please support your suggestions with clear justifications, examples and accompanying illustrations.

Public comments

5.2 All respondents agreed to the proposal that a company should comply with the environmental and social components of the Principles-Based SRI Taxonomy in order to assess whether its economic activities can be deemed as sustainable.

5.3 Some of the key highlights of the feedback from respondents include, providing additional examples on the assessment of the sustainability component under the Principles-Based SRI Taxonomy. There was also a suggestion to include additional considerations for an economic activity to be qualified as sustainable, such as governance, bribery, corruption, requirements on board and management.

The SC's response

5.4 The SC recognises the importance of governance as a foundation of ESG and sustainability. While the Principles-Based SRI Taxonomy provides guidance on the classification of economic activities that are aligned with environmental, social and sustainability objectives, it is anticipated that users of the Principles-Based SRI Taxonomy are also required to comply with governance considerations, as per the relevant national governance standards, guidelines and frameworks.

ABBREVIATIONS

BNM	Bank Negara Malaysia
CCPT	Climate Change and Principle-based Taxonomy
DNSH	Do No Significant Harm
ESG	Environmental, Social and Governance
EU	European Union
SDG	Sustainable Development Goal
SRI	Sustainable and Responsible Investment