CASE STUDY

Responsible Finance Champions

The call to action

In 2017, Bank Negara Malaysia (“BNM”), the central bank of Malaysia, began an engagement with Islamic banks on whether Islamic financial institutions could deepen their contribution to meeting the higher Shariah objectives on which the industry is founded. After receiving input from the Islamic banks represented in Malaysia’s Community of Practitioners, BNM concluded a public consultation that led to a final strategy paper being completed in May 2018.

The process provided the framework from which BNM, with input from the Community of Practitioners, drew up a responsible finance implementation guide for Islamic financial institutions in October 2018. Announcing the Implementation Guide for Value-based Intermediation, BNM’s Governor Nor Shamsiah Mohd Yunus made a call to action: “It is increasingly clear that economic prosperity in the long run cannot exist without social equity and environmental responsibility. With much at stake, the call to action for sustainable finance is one that the financial sector, perhaps more particularly Islamic finance, cannot afford to ignore.”

Coinciding with this process, CIMB Islamic Bank (“CIMB Islamic”) began considering how its corporate values could translate into action as an Islamic financial institution. Rafe Haneef, CEO of CIMB Islamic, explained the connection that motivated the bank’s actions: “Islamic banking was founded on the core principles of promoting social justice through financial intermediation. From the very beginning, Islamic banking has been focusing on reducing harm and maximising benefit for the society, such as by avoiding financing sectors which cause broad negative impact to society.”

1 These objectives include the preservation of faith, life, family, intellect and wealth; as well as the overall goals of maximising benefit and minimising harm to individuals and society.

A turning point for sustainability

As CIMB Islamic explored the fundamental proposition for Islamic finance and responsible finance, the process began with informal discussions that encouraged Mr. Haneef to take the issue of sustainability and responsible finance beyond the confines of the Islamic bank. Luanne Sieh, Group Head of Sustainability at CIMB Group, noted that at the end of 2017 Mr. Haneef elevated the discussion into a wider discussion across the whole of CIMB Group when he spoke about sustainable finance at a gathering of the bank’s top 300 leaders.

Ms. Sieh explained how this moment became so transformational for the bank, elevating the sustainability discussion from a narrow focus on the ethical case into a part of the strategic planning for CIMB Group’s future. She said: “There was a lot of interest in sustainability within the bank and the discussion came at the right time, where it led to presentations to the board members overseeing Forward23, the new five-year transformation strategy that CIMB Group was debating and developing at that time.”

The pick-up of interest at the strategic level was particularly important, according to Hussam Sultan, Regional Islamic Head of Commercial and Transaction Banking at CIMB Islamic. He explained that there is “a community of people within CIMB Group who were passionate about sustainability who had set a mission to transform their own understanding and vision to institutionalise the concept”. According to Mr. Sultan, all banks have people with passion and vision for sustainability working for them, but often they don’t see how it can be adopted more widely across the institution for which they work.

How sustainability became a strategic priority

In the same way that Mr. Haneef built vertical links rising from within CIMB Islamic to the Group CEO’s office and the Board of Directors, the concept of sustainability was born and developed horizontally across different levels within CIMB Group. Within the Group CEO’s office, Ms. Sieh looked at the results of their midterm strategy development, which involved many internal and external stakeholders.

Each of these stakeholders was asked to identify the key areas that the bank needed to focus on in the next five years. Ms. Sieh was surprised that sustainability came up unprompted as one of the top items from employees, as well as from shareholders and investors, which reinforced their initial thoughts to include sustainability in the strategic planning process. Ms. Sieh noted that the breadth of interest they received elevated it to become one of the five key pillars of the Group’s transformation strategy.

Although the path from internal dialogue to strategic pillar began from the passion and visions of internal champions in CIMB Islamic or the Group CEO’s office, it was put through a rigorous process of internal review involving many stakeholders. The buy-in process was important, Mr. Haneef said, because “If a company adopts sustainability only to meet the expectations of regulators or other stakeholders, it is less likely to improve its return on capital, which requires making a complete shift internally and externally towards these sustainable goals.”

Mr. Haneef put the internal stakeholder engagement at the forefront of the bank’s success in building sustainability up to become a strategic pillar. The initial points of concern from within the organisation centred on the process being something new that changed business as usual. In particular, there were concerns that sustainability would become just a new cost driver and could potentially impact the Group’s bottom line.

For CIMB Group, the process took two years and started with management, the board of directors, and shareholders. Mr. Haneef explained that in the process of getting all of these key stakeholders on board, some of them needed time to become comfortable with an internal shift towards sustainability. Each will start with a range of perceptions about how sustainability affects the bank, such as the perception that it will be primarily a cost-driver. One major point of concern was about the impact that adopting responsible finance practices would have on the bank’s return on capital and its market valuation.

The process of engagement to generate buy-in was driven internally by leadership engaging with different stakeholders, but benefitted also from working with third parties. For example, Mr. Haneef said senior management and the board went to meet with other banks that had adopted sustainable practices. He explained that “the impact that the board and management saw was huge in terms of employee satisfaction and employee retention, which we did expect to see from the beginning.”

Mr. Haneef added: “The banks who engaged in sustainable practices and sustainable finance were able to get better talent, and their talent retention was also higher. They had a better set of customers who naturally are better citizens. The customers not only complied with the best environmental practices, but they proved to be better obligors. This drove home the point that increasing customer quality drives financial performance and delivers results to shareholders.”

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- Rafe Haneef, CEO, CIMB Islamic Bank
Shareholders weigh in

Shareholders were an important stakeholder group supporting CIMB Group’s move towards sustainability. About a quarter of CIMB Group’s shareholders are international fund management companies, which approached the conversation from the perspective of complying with best practices on environmental, social and governance ("ESG") integration at the encouragement of the UN-supported Principles for Responsible Investment ("PRI").

Another quarter of shares are owned by a Malaysian sovereign fund, Khazanah Nasional, which is an asset owner signatory to the PRI and has been increasing its scrutiny of investee companies’ ESG practices since joining the PRI in early 2017. These shareholders who are signatories to the PRI have committed to be active owners, working through engagement with their investee companies to improve ESG practices and reporting.

Mr. Haneef said it was helpful that CIMB Group’s board and shareholders were asking management the right questions about return on capital, market valuation, and our policies on environmental and social issues in order to identify sustainability as a strategic pillar. The shareholders’ input, which added further rigor to the board of directors’ inquiries, was constructive for the overall process and led to the CIMB Group Board of Directors seeing sustainable finance as a strategic differentiator that could shape the future of CIMB Group.

One of the values that the board and strategic shareholders identified was the connection between the sustainability practices at the bank and the stickiness of the investor base. Many of the international investment funds that own shares of CIMB Group are invested based on its long-term value, which is enhanced by the strategic focus on sustainability. Ms. Sieh gives the example of a European pension fund who values sustainability and is actively encouraging its investees to take more action to become sustainable.

Investors like these take a long-term perspective with their investments based on a strict ESG analysis. As a result of their responsible investment screening, which is based on long-term factors including ESG, they are comfortable holding onto the shares of more sustainable banks throughout an entire economic cycle, which provides a benefit to the bank by having a more stable investor base. Ms. Sieh explained, “Some of our local investors and clients still need more education about the value of sustainability and we have to also work to communicate out to our business relations about why we’re taking the sustainability perspective so they will understand how it affects them.”

Not all shareholders come from this perspective and it will take time to convince all shareholders and other stakeholders in the bank. As the process of engagement between CIMB Group and its stakeholders continued, Mr. Haneef explained that “we needed to engage with third parties who have gone through this journey before to use their experiences to help convince our various stakeholders through the process of bringing them to be supportive of sustainability.”

From adoption to implementation

When sustainability was adopted as one of the five key pillars of Forward23, CIMB Group’s new strategic plan for the period 2019 - 2023, the mind-set shift at the top level that began two years earlier was largely completed. Shareholders, board members and key members of senior management were convinced that sustainability was the right thing to do for people and planet as well as for CIMB Group.

Mr. Haneef said: “We showed that by making sustainability a strategic part of our process, the quality of the portfolio will also improve because we’ll be financing more good citizens who are also good obligors. There is evidence of a link between firms who will meet the commitment not only to the environment but also to the banks for the financing they have taken, which makes it a win-win situation for the bank, for customers, and to the people and planet as a whole.”

CIMB Group’s Ms. Sieh explained that “employees may come with the perception that sustainability exclusively involves giving donations to good causes and not fully appreciate the scope of what our sustainability framework entails.” This shows the importance of the same level of mind-set shift that has

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Customer Centricity

Our People

Ventures & Partnerships

Future Proofing
happened across senior levels being spread throughout the Group, which involves a process of capacity building across the management level.

This transformation would require wider efforts to build capacity through the Group’s 36,000 staff across 16 countries. In line with its responsible banking commitment, some business practices will have to evolve to introduce new sustainability-related products; such as preferential rates for new hybrid car financing and special mortgage pricing for certified Green Buildings, which were introduced in 2018.

Mr. Haneef credits younger employees for the success of this and sees a benefit in engaging this demographic, which banks often struggle to attract and retain. He said, “Our millennials have been a key element of support towards achieving our sustainability objectives.”

Sustainability Materiality Assessment

When the time came for CIMB Group to outline its sustainability and sustainable finance roadmap, it set out a comprehensive process for assessing materiality and consulting with many key stakeholder groups including customers and clients, suppliers, employees, CSR beneficiaries, and the local community.

The outreach to stakeholder groups differed based on the characteristics of each group and included surveys, focus groups, one-on-one interviews, and informal conversations. Input was gathered about what each stakeholder group considered material. The process was challenging as a result of the broad scope and the diversity of actions that CIMB Group was targeting to make the whole bank more sustainable.

This first cut of materiality was based on the stated priorities of each stakeholder group. The finalised top 14 material topics, which include 6 Highly Material Issues and 8 Important Topics (listed at the bottom of the page), will remain CIMB Group’s key areas of focus over the next 3-5 years. For each of the material topics, CIMB Group has clearly articulated the strategic link to its business, the risks and opportunities, and its long-term strategy.

Putting in place a sustainability framework

When translating policies into actions with the intention of conducting a review of their effectiveness, it is important to set a baseline so that impact measurement later can credibly demonstrate progress. Without a baseline, there is significant flexibility to adjust the way that future impacts are reported.

The first part of the framework focuses on sustainable actions, which include the internal activities of CIMB Group such as its carbon footprint and hiring practices. CIMB Group’s Head of Sustainability, Ms. Sieh, said CIMB Group “hasn’t started setting targets in some areas because we lack a baseline, while in other areas we are quite comfortable setting targets.” She gave senior leadership capacity training as one of the latter topics, and said there is a target to have all board members and top management trained during the next two years.

In other areas, the technical capabilities for measurement were not in place before the sustainability framework was developed, including measuring CIMB Group’s greenhouse gas (“GHG”) Scope 1 and Scope 2 emissions. The measurement of these emissions began to be collected mid-year in 2018, so a full year of data that would serve as a relevant baseline will not be available until that full year has passed.

### LIST OF 6 HIGHLY MATERIAL ISSUES

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### LIST OF 8 IMPORTANT TOPICS

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Scope 1 emissions are those emitted directly by CIMB Group, such as the tailpipe emissions created by gas-powered automobiles owned or leased by CIMB Group and driven by its employees. Scope 2 emissions would include the indirect emissions used in generating power for CIMB Group’s branches.

The second part of the framework focuses on sustainable business, which requires a different type of evaluation including another set of diverse considerations, for example how to improve financial literacy with retail customers. In financing start-ups and small businesses, the considerations involved include deciding how to measure the bank’s ability to help customers break out of the cycle of poverty and increase employment. With respect to larger and more established businesses that may be focused on renewable energy, it would be desirable to measure how much CIMB Group grows its financing of such businesses over time.

These objectives are then combined with the other pillars of CIMB Group’s sustainability framework, which includes a third pillar focused on aligning corporate social responsibility with the Sustainable Development Goals (“SDG”), as well as implementing an impact measurement framework. As a fourth pillar relating to governance and risk, CIMB Group has set up controls to enforce responsibility for sustainability beginning at the Board level with the establishment of a Group Sustainability Council chaired by the Group CEO, the implementation of a Group Sustainability Policy which is embedded into other policies and procedures within CIMB Group, as well as inclusion of Sustainability Risk into CIMB Group’s Enterprise-wide Risk Management Framework. The fifth and final pillar of CIMB Group’s sustainability policy relates to advocacy, training, capability building and engaging on responsible finance.

CIMB Group recognises its influence towards sustainable and ethical business practices. It adopts an inclusive approach to all its business relations and strives to positively influence their own sustainability performance and commitment. However, it also recognises that what its partners do and how they conduct their own business can have a direct impact on CIMB Group’s own projects, business continuity, as well as reputation. It is therefore critical to monitor the social and environmental impact and take necessary measures towards positive impact.

- **Business Relation Assessment**

  The assessment begins with a basic due diligence to assess the sustainability risk of business relations so that it does not knowingly engage in business activities or with business relations that do not meet the Group Sustainability Policy requirements. CIMB Group will exercise a precautionary approach, taking due care and diligence to evaluate, adopt and advocate measures that will minimise and in the long-run prevent, environmental harm as well as promote social equity.

- **Sustainable Financing Assessment**

  Separately, the focus on the client portfolio was driven by a recognition that the greatest indirect impact that CIMB Group creates comes from what its clients do with the financing it provides. This analysis resulted in a list of key sensitive environmental and social risk sectors, and CIMB identified the material topics relevant to each of these sectors.

  Therefore, when new or increased business financing is being sought, the nature of financing will be examined. If it does not fall into a high risk sector, basic sustainability due diligence will apply. If it does not pass this criteria, it will then be subjected to enhanced sustainability due diligence. However, if the nature of financing falls into a pre-identified high risk sector, enhanced sustainability due diligence will automatically apply.

Not all of the policies are necessarily focused on identifying risks. For example, to encourage positive behaviour and sustainable lifestyle choices, clients applying for mortgage financing of green-certified homes are able to receive lower-cost financing at CIMB Bank or CIMB Islamic. If more buyers become incentivised to buy green homes, this may influence developers’ choices to favour projects that are green certified to increase their saleability.
“CIMB Group takes sustainability as a business opportunity when we look at the deals, transactions and financing opportunities it creates. The shift to a low-carbon economy has created a number of new sectors and opportunities in Malaysia and globally.”

- Hussam Sultan, Regional Islamic Head of Commercial and Transaction Banking at CIMB Islamic Bank

CIMB Islamic’s Mr. Sultan added that the opportunities go beyond just tilting actions by consumers towards being more sustainable. He said, “CIMB Group takes sustainability as a business opportunity when we look at the deals, transactions and financing opportunities it creates. The shift to a low-carbon economy has created a number of new sectors and opportunities in Malaysia and globally.”

In Malaysia, for example, the government has committed to increase the renewable energy capacity mix from 2% today to 20% by 2025. Globally, the investment needed is even larger, and the financing opportunities for infrastructure to make the transition to a low-carbon economy capable of meeting the 2° C target of the Paris Agreement is estimated to reach $90 trillion by 2030.1

While this immense transition is underway, all the same players are also responsible for maintaining economic growth, providing services that all vibrant economies like Malaysia’s needs, and creating job opportunities. This will require a significant degree of cooperation between governments, financial institutions including Islamic financial institutions, non-financial corporates, and international organisations.

Shariah supervision and sustainability

Throughout the process that was occurring across CIMB Group, there was a related effort underway within CIMB Islamic to engage its Shariah board on sustainability. The Shariah advisory department within CIMB Islamic proposed a sustainability integration in line with a resolution issued by the Organisation of Islamic Cooperation (“OIC”) Fiqh Academy on environmental sustainability. The Fiqh Academy’s resolution was issued in 2009. CIMB Group’s Shariah advisory head, Ashraf Gomma Ali summarised it as including three resolutions:

1. It is prohibited to dump any harmful waste on any part of the earth;
2. It is prohibited to undertake any activity that leads to any environmental harm, such as activities that damage the ecological balance or that use resources in an unsustainable manner that do not consider the interests of future generations;
3. It is prohibited to release gases that contribute to the deterioration of the ozone or pollute the environment.

CIMB Islamic also suggested that the bank sign onto international frameworks like the UNEP FI Principles for Responsible Banking. The Shariah board supported this and strongly recommended the adoption of sustainability practices and also highlighted that in order to address the challenge of embedding sustainability throughout the Group, the bank would need a dedicated sustainability department to fulfil this requirement.

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When CIMB Group adopted sustainability and sustainable finance policies that incorporated the Shariah scholars’ feedback, Mr. Gomma Ali, returned to receive the Shariah board’s approval. The board signed off on the sustainability policy at that point and was pleased to see that CIMB Group had demonstrated it was devoting sufficient resources and headcount across different geographies to ensure the sustainability concept could be implemented effectively.

The way forward for Islamic finance and sustainability

Building this type of broad agreement between the management side within a bank and its Shariah oversight is helpful to achieving constructive progress on the agreed goals. These include global goals such as the Sustainable Development Goals and the Paris Agreement. Mr. Gomma Ali said the efforts to create the SDGs “represent the collective effort of the international community to determine what is harmful and how to create action on the ground to mitigate the harms, and it is very well within the Shariah framework of maximising benefit and minimising harm.”

“By being a member of the RFI Foundation and a signatory to UNEP FI, we believe that CIMB Group can be a catalyst in terms of pushing other stakeholders in the market including financial institutions, investment holding companies, institutional investors and fund managers to adopt sustainability.”

- Rafe Haneef, CEO, CIMB Islamic Bank

CIMB Islamic’s Rafe Haneef referenced these global goals and the local impact for CIMB Islamic within Malaysia as being important to help the country meet its Intended Nationally Determined Contribution (“INDC”) under the Paris Agreement. Under Malaysia’s INDC, the country has committed to reducing emissions by 35% by 2030 on its own and by another 10% with international support through climate finance, technology transfer, and capacity building.4

“It’s an important target to meet by 2030 and CIMB Group’s shift towards sustainability can help the government meet its own commitments under the Paris Accord,” said Mr. Haneef. He added that “the sustainability journey that we have embarked upon will not only affect our own ability to create positive impact for people and planet but will ensure that Malaysia as a country meets its own targets under the Paris Accord. By being a member of the RFI Foundation and a signatory to UNEP FI, we believe that CIMB Group can be a catalyst in terms of pushing other stakeholders in the market including financial institutions, investment holding companies, institutional investors and fund managers to adopt sustainability.”

Mr. Sultan said: “Our journey can be replicated but it needs other champion banks from across the ASEAN region in addition to CIMB. These banks need to have champions for responsible finance within their organisations to build an internal network. Industry/external leadership for an institution begins by having a leader within the organisation, and the example that Rafe Haneef has demonstrated in kick-starting CIMB Group’s journey starting within CIMB Islamic.”

Mr. Gomma Ali said: “Islamic finance didn’t focus on sustainability earlier because we didn’t have the capacity to do it. There’s a verse in the Qur’an that says a person is not held accountable for more than they can bear. The industry was just starting off and so we were following just the minimum standard in order to get our foot in to this global financial system. Now it is time for Islamic finance to take sustainability and responsible finance very seriously, and take leadership on the trend of doing well for people and planet.”

Ms. Sieh said: “We had a senior leader who was vocal and passionate enough to garner interest at the senior level. We had a push from the regulator, Bank Negara Malaysia, on the Islamic banks through Value-Based Intermediation. We had people involved with a deep knowledge of the internal working of the organisation. From there, it came down to effort and execution to operationalise sustainability through good policies, a dedicated department, and the budgets needed to support good delivery. What we have created at CIMB Group is a repeatable formula.”

Mr. Haneef concluded, “The initial realisation and strategy development has been completed but for us, the journey has just begun and we are committed to working with all stakeholders to ensure the success of this initiative, even beyond CIMB Group’s current five-year growth strategy.”

The sustainability journey at CIMB Group was spearheaded by the CEO of CIMB Islamic with oversight from the Group CEO, together with Group Strategy and Design. These actions undertaken by an Islamic banking subsidiary within a regional banking group provide a proof-of-concept reference of how a bank can feasibly adopt and incorporate sustainability meaningfully and systematically into its business strategy. As other banks consider their approach to sustainability, they can benefit from some lessons that CIMB Group identified in its own journey.