

# **VBIAF Sectoral Guide Town Hall**

## ***Renewable Energy***



**Value-based Intermediation (VBI)**  
*Strengthening the roles & impact of Islamic Finance*

10 Sept 2020

# Definition and scope

## Scope

The guidance provided will primarily focus on the direct impact of **Upstream power producers** (e.g. public and private utilities providers), for example-

- i. **Solar PV** installations, including both land based and floating developments;
- ii. Processing plants installation for **biofuels** and **biomass**; and
- iii. **Hydroelectric** power plants, including impoundment infrastructure (dam structures), river diversion structures (run-of-river), and pumped storage.

## Exclusions

This edition does not include wind and geothermal.

## Applicability

1. **Direct impact** of upstream power producers
2. Considerations will be given to significant **indirect impacts** within the RE value chain, that could give rise to both financial and operational risks, for example-
  - i. responsible sourcing of raw materials and feedstock;
  - ii. appropriate lifecycle analysis, including waste management processes and decommissioning of the plant,

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## Commercial proposition

In effort to further reducing Malaysia's CO2 emissions, there is a need to decarbonize the electricity sector further. Renewable Energy Transition Roadmap (RETR 2035) targets to increase RE to 20% of national installed capacity (excluding large hydro) by 2025 Any hydro above 100MW. Current RE Schemes in Malaysia include:

RE Resources	Eligible RE Schemes
Solar PV	Net Energy Metering (NEM)
	Large Scale Solar (LSS)
	Self-Consumption (SELCO)
Biogas	Feed-in Tariff (FiT)
Biomass	
Small Hydro	

- The **FiT mechanism (2011)** allows electricity that is produced from bioenergy and small hydropower plant to be sold to power utilities at a fixed price and for a specific duration.
- **Net Energy Metering (NEM) and Self Consumption (SELCO) schemes** - provides financial support to encourage Malaysia's offgrid PV system uptake for electricity generated for own use (SELCO) and excess exported to TNB on a "one-on-one" offset basis (NEM).
- **LSS Scheme** - Competitive Bidding Program for The Development of Large Scale Solar Photovoltaic Plant (LSS)
- **GTFS 2.0** provides financial support through participating FIs for producer, user and ESCOs (to finance investment or assets related to energy efficiency project and EPC). Government guarantee on financing provided by FIs. GTFS 2.0 aims to accelerate the expansion of green investments with a total funding up to RM2 billion
- **GITA & GITE**- Investment tax allowance and income tax exemptions for the purchase and use of green technology equipment.

# Impact-based risk categories

## Risk Assessment Approach

Environmental and Social risk could result in financial and reputational impact to banks

FI's should develop a risk management framework to manage environmental risk in a systematic and consistent manner.

**Client level assessment** - Benchmarks clients' E&S risks and track record in managing such risk prior to onboarding and ongoing:

- *FIs should, as part of its due diligence process, assess and monitor the counterparty's commitment, capacity and track record in environmental and social risk management.*
- *FI's may deem a counterparty that is certified with an established certification standard, such as a nationally mandated one to have sufficiently managed the key impact-categories/ themes.*

**Transaction level assessment** - applicable to a project or an asset, benchmarks against specific E&S risk criteria:

- *Effective management is evidenced by amongst others, clear and comprehensive policy and procedures, adequate reporting and monitoring, appropriate grievance/ complaints mechanism and sufficient rectification planning.*
- *FIs should consider independent information obtained either internally or externally such as audit/ surveillance reports, compliance reports, reports/ filings/ checks with regulatory authorities and/or civil societies (if available), and news reports.*

## Risk metrics for the RE sector

### E&S issues for consideration

Renewable sources such as wind, solar, geothermal, biomass, and hydropower also have **environmental and social impacts**, some of which are significant depending on the specific technology used, lifecycle stage and the geographic location. Global PV waste streams for example, are estimated to grow from 250,000 tonnes at the end of 2016 to more than five million tonnes by 2050. Other issues include:

- *Land access, land use change and acquisition;*
- *Biodiversity loss and deforestation;*
- *Water usage;*
- *Pollution - waste, effluents, air emissions;*
- *Labor rights and working conditions;*
- *Occupational health and safety;*
- *Community relations;*
- *Human rights;*

**Table 7. Example of decision making rule.**

Unacceptable risk	Transaction involving activities on the exclusion list. This includes existing counterparties that exhibit continuous poor impact performance. No approval should be given.
High risk	Scores “High” for the majority of key impact categories/ themes but has satisfactory mitigation strategy. Approval must be subject to strict compliance conditions/ covenants.
Medium risk	Scores “Medium” or “Low” in the majority and exhibit evidence of effective mitigation strategy. Approval can be subject to standard compliance conditions/ covenants.
Low risk	Scores “Low” for the majority of key impact categories/ themes and exhibit evidence of effective mitigation strategy. Approval can be subject to standard compliance conditions/ covenants.

The risk score/level provided is an example. FIs can use either a numeric score (1-5) or categorization (High, Medium, Low) according to their respective internal risk methodologies. FIs should determine the appropriate risk score/level based on their respective risk appetites



## Impact-based risk management

FIs need to have appropriate and adequate protection and establish clear procedures and escalation processes to:

### ***Do less harm (Reactive measures)***

- i. Identify applicable laws/ standards/ certification related to RE and require the counterparties to obtain relevant certifications or comply with relevant regulatory requirements.
- ii. Identify standard representations and warranties to be produced by customers e.g. EIA report, compliance with laws and standards
- iii. Identify escalation procedure including remedies/ penalties and event of default.
- iv. Identify time bound rectification plan in the event of impact-based noncompliance/ breach.

### ***Do more good (Proactive measures)***

- i. Identify incentives, if applicable e.g. step-down pricing if meet certain impact-based targets e.g. sustainability linked loans,
- ii. Offering green financial products to incentivize clients to improve their sustainability practices e.g. reduced margin based on pre-determined target relating to improvements in RE.
- iii. Collaborate with relevant government agencies/ NGOs to provide training/ awareness programmes and advisory services on RE programme by agencies.

## Opportunity for Financial Institutions

With the VBIAF framework combined with Governmental support in form of various policies and schemes, the opportunity for Financial Institutions exists to grow this segment:

- i. Adopt a standardized approach under VBIAF to enhance customer experience.
- ii. Consumer awareness through industry focused sessions
- iii. Initiatives supporting RE financing such as:
  - i. Package for financing of end user solar installations;
  - ii. Linking B2C via possible alliances with manufactures;
  - iii. Pricing incentive to gain market share
- iv. Marketing of propositions support RE to create awareness.
- v. Impact reporting