How asset owners will make ESG count in Asia

Key findings from an AsianInvestor / S&P Dow Jones Indices survey show clearer direction and growing appetite for more sustainable themes in investor portfolios.

In partnership with

S&P Dow Jones Indices

A Division of S&P Global
The objective of the survey, entitled "Does ESG Matter?", was to understand how, why and where ESG themes and related processes are impacting portfolios and asset allocation – an increasingly important topic given investing with sustainability in mind is fast-becoming the norm for more and more institutions.

**EXECUTIVE SUMMARY**

Survey respondents included senior investment executives from 38 institutions across Hong Kong, China, Taiwan, Korea, Japan, Singapore, Thailand, Malaysia, Indonesia, the Philippines and India.

Ranging from sovereign wealth funds, government entities and endowments, to insurance companies, public and corporate pension funds, and family offices – they represent a combined $1.5 trillion in assets under management (AUM).

Among the key take-aways from these investors:

- Nearly three-quarters (71%) point to either a "high" or "medium" likelihood of increasing ESG factors in their portfolios over the next 12 months.
- The three most ESG popular investment themes in 2020 are: clean energy; lower carbon emissions; and improved governance.
- Amid various drivers to incorporate ESG considerations in investment decisions, 24% say their motivation is to enhance the public image of the organisation, with the same number looking to improve returns.
- As at the end of the first quarter of 2020, just over two-thirds (68%) had less than 10% of their portfolio invested in ESG-related mandates.
- Their two biggest concerns about embracing ESG are a lack of quality or standardised data, and a limited understanding internally about the value of ESG.
- Just over one-third (37%) believe clearer governance and ESG processes internally would help in incorporating ESG in a more meaningful way in the investment process.
- 42% say the responsibility for driving ESG standards should come from governments and regulators.

**BUILDING FROM A LOW BASE**

Appreciation of the value of ESG in terms of returns is perhaps one of the few "positives" to emerge from the negative impact of Covid-19, on both the macro landscape and on asset prices.
There is clear evidence of the resilience of ESG funds in parallel with growing investor interest during the market volatility stemming from the pandemic in the first quarter of 2020. In short, many companies and investment funds which take these issues seriously were able to outperform their peers.

Research by S&P Global Market Intelligence, for example, highlighted this. In a dive into the performance of 17 exchange-traded and mutual funds with more than $250 million in AUM that use ESG criteria to select stocks, the firm found that 12 of them lost less value since the beginning of the year than the S&P 500 index.

According to Morningstar, meanwhile, the global sustainable fund universe pulled in $45.6 billion in the first quarter of 2020. This compares with an outflow of $384.7 billion for the overall fund universe during the same period.

Yet based on the survey results, many Asia-based asset owners remain behind the curve – for the time being. More specifically, over two-thirds (68%) of respondents said they have less than 10% of their portfolio currently invested in ESG-related mandates. And only one-fifth of them have an exposure that accounts for over 20% of their portfolio.

In general, the biggest concern about adding or expanding ESG – according to survey respondents – is a lack of quality or standardised data. Many respondents also said there is limited understanding internally about the value of ESG, with the additional costs of analysis and required due diligence among other key issues that weigh on investor’s minds.

GETTING INVESTED
At the same time, however, it seems those asset owners who are more actively engaged in ESG realise its value – for 14% of respondents, for instance, more than 50% of their portfolio has an allocation to relevant themes.

It is in such findings that optimists would say lay the foundations for change, despite relatively low engagement of ESG in portfolios to date within Asia’s institutional investor segment.

The survey results certainly point to a desire for more sustainable themes in portfolios. Just over 70% of respondents admitted either a “high” (34%) likelihood of increasing ESG factors in their portfolios over the next year – meaning those firms that have already invested in ESG themes and will allocate more, or a “medium” (37%) likelihood – meaning they might invest but want more information or proof of value add.

Only 7% of respondents said they don’t place any value on ESG in impacting portfolio returns.

WHAT ARE YOUR BIGGEST CONCERNS ABOUT ADDING OR EXPANDING ESG IN YOUR PORTFOLIO?

WHICH “E” AND “S” THEMES WILL YOU FOCUS MOST IN 2020?
For those asset owners with a focus on ESG, the environment is proving most popular as an investment theme for 2020.

In particular, clean energy and lower carbon emissions are the priority for respondents. Water management and sustainable transport are also on investors’ hit lists.

In terms of social themes, ageing population and technology will also see inflows this year.

Ultimately, improving returns is at the top of the list of advantages that survey respondents perceive from incorporating ESG considerations in investment decisions.

While this is aligned with another of the key ESG drivers for investors – helping to ‘future proof’ an investment portfolio, both of these contrast with the other most popular objective for asset owners who responded to the survey: simply to enhance the public image of the organisation.

**MAKING ESG COUNT**

Those institutions looking to incorporate ESG factors in a more meaningful way in their investment process know that sustainability is essential in more ways than just a target asset’s characteristics.

In line with this, clearer governance and ESG processes internally would be most effective in providing the required support, according to 37% of respondents.

Other important components include a wider range of choices in terms of ESG assets, followed by more resources to assess these opportunities along with stronger leadership to define the ESG strategy.

The significant scope for greater engagement of ESG going forward also tallies with the views of well over half (56%) of survey respondents on their expectations about how implementing ESG in portfolios will positively impact annual risk-adjusted returns over the next five years.

Of these investors, 27% said it will ‘strongly improve’ returns via an additional 1%+, with 29% forecasting it to ‘slightly improve’ them, with a target of between 0.1% and 0.99%.

In comparison, only 12% of respondents believe ESG will lead to a reduction in annual risk-adjusted returns over this period. Just over one-quarter (27%), meanwhile, don’t think it will have a material impact on their portfolios.

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**SURVEY**

**WHAT IS THE MOST IMPORTANT ADVANTAGE OF INCLUDING ESG-RELATED THEMES IN YOUR PORTFOLIO?**

- **24%** Improves returns
- **24%** Good for the public image of the organisation
- **22%** Helps to ‘future proof’ our investment portfolio
- **10%** Alignment with UN SDGs to please management and/or shareholders
- **8%** To meet regulatory requirements/preferences
- **7%** Other
- **5%** Improves due diligence

**WHAT WOULD BE MOST EFFECTIVE IN HELPING IMPLEMENT ESG IN YOUR INVESTMENT PROCESS?**

- **37%** Clearer governance and ESG processes internally
- **22%** A wider range of choices in terms of ESG assets
- **15%** More resources to assess investment opportunities
- **15%** Stronger leadership to define our ESG strategy
- **7%** More cooperation and collaboration with external managers and other partners
- **5%** Other

**WHO SHOULD BE RESPONSIBLE FOR DRIVING ESG STANDARDS FOR ASSET OWNERS?**

- **42%** Government/regulators
- **20%** Senior management/investment committee
- **15%** CIO/investment team
- **12%** Shareholders/members
- **7%** Public pressure
- **4%** Other
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