

# Making ESG mainstream in Asian portfolios

In partnership with

## S&P Dow Jones Indices

A Division of **S&P Global**

*While sustainable investment themes and practices are making steady in-roads across the region, the pace would increase with greater asset choice and standardised data, finds the latest AsianInvestor / S&P Dow Jones Indices ESG poll.*

The pandemic has proven a time to shine for mandates that invest with ESG principles in mind. Fueled by an accelerated appetite for sustainable funds in Asia, Morningstar data for the third quarter of 2020, for example, showed a record high \$8.7 billion of net inflows. This helped total ESG fund assets in Asia to reach \$25.1 billion, up 75% from the previous quarter.

Investing through an ESG lens has become more common in line with growing evidence that companies with good characteristics are expected to be more resilient during a crisis. Yet it is easier said than done to find relevant investments, integrate ESG in decision making and evaluate different managers and strategies.

To assess the tangible influence of ESG

on portfolios and on potential drivers for future engagement, a new survey by *AsianInvestor*, in collaboration with S&P Dow Jones Indices (S&P DJI), gathered insights from 85 senior investment executives in October and November 2020.

Key take-aways from these government entities, insurers, pension funds, private banks and other investors – across, Hong Kong, Taiwan, Australia, South Korea, Japan, Singapore, Thailand, Malaysia, Indonesia, the Philippines and India – include:

- Just over 70% have less than 10% of their current AUM invested in ESG-related mandates
- Amid the pandemic, 49% of investors have either already increased their exposure to ESG funds, or plan to – however, 46% of respondents said

Covid-19 has made no difference to their ESG-related exposure

- The two key drivers to invest based on ESG factors are to improve returns and add longer-term portfolio resilience
- Environmental themes will see the biggest inflows in 2021 – especially clean energy and lower carbon emissions
- More standardised ESG data would have the biggest impact in encouraging investors to boost their ESG exposure
- Traditional metrics remain the preferred approach to assess different ESG funds – notably, the track record of the investment strategy and fund performance over the benchmark

**DEMAND DRIVERS**

The responses to the survey reflect the impact of Covid-19 on investors' exposure to ESG funds.

Almost a quarter of the investors who participated are allocating more to these investments, with nearly half of them revealing a jump of more than 5%. At the same time, 25% of respondents plan to allocate more to ESG funds going forward.

Yet for almost half of the investors, the pandemic has made no difference to their interest in ESG funds.

"We have seen an increasing appetite for investor education on ESG topics, but there is still more work to be done to turn this into larger shifts in capital," explains Manjit Jus, managing director and global head of ESG research and data at S&P Global.

Indeed, more broadly, the survey findings show that for many investors in Asia, the impact of increased focus on ESG considerations still has a long way to go in terms of the overall influence of these factors. For example, for nearly three-quarters of respondents, less than 10% of their overall portfolio is invested in ESG-related mandates. In fact, a relatively small proportion of investors in the survey have exposure to such investments in more than 20% of their portfolio.

For those asset owners who invest in line with ESG factors in the current

environment, the two clear drivers for them to do so are: to improve returns in their bid to outperform the benchmark; and to help add longer-term resilience to their portfolio.

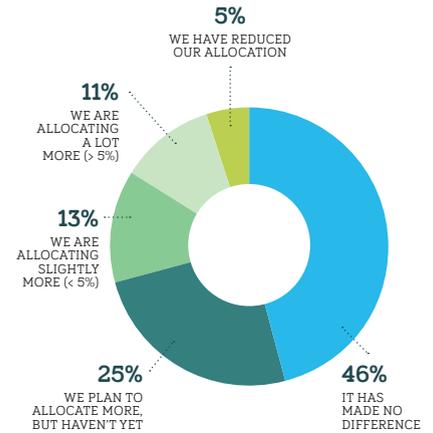
The rising importance of sustainability in general is also having an influence. For instance, being aligned with management commitment to 'do good', and enhancing the public image of the organisation, are now spurring more interest.

The latest rebalancing and reconstitution of the Dow Jones Sustainability Indices (DJSI) reinforces the value of investors taking this tilt. More specifically, 2020 saw a record 19% increase in the number of companies actively completing SAM's Corporate Sustainability Assessment (CSA) – which consists of a rigorous questionnaire assessing both public and non-public data submitted by participants.

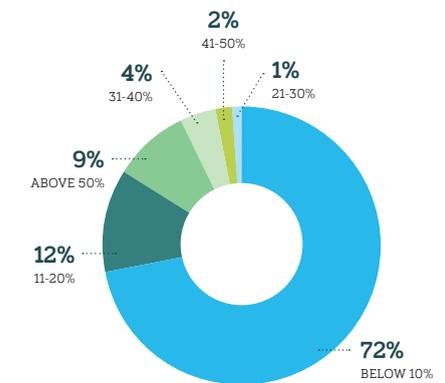
According to Jus, this rise in engagement reflects the fact that management in many companies have upped the ante in terms of their focus on sustainability. "They see the need to demonstrate that they are responsible citizens and have embedded long-term thinking and ESG in their strategies in times of market turmoil and uncertainty," he says.

This fits the trend Jus sees of more and more companies talking differently about risk and how to approach it. This is based on the degree to which Covid-19 showed

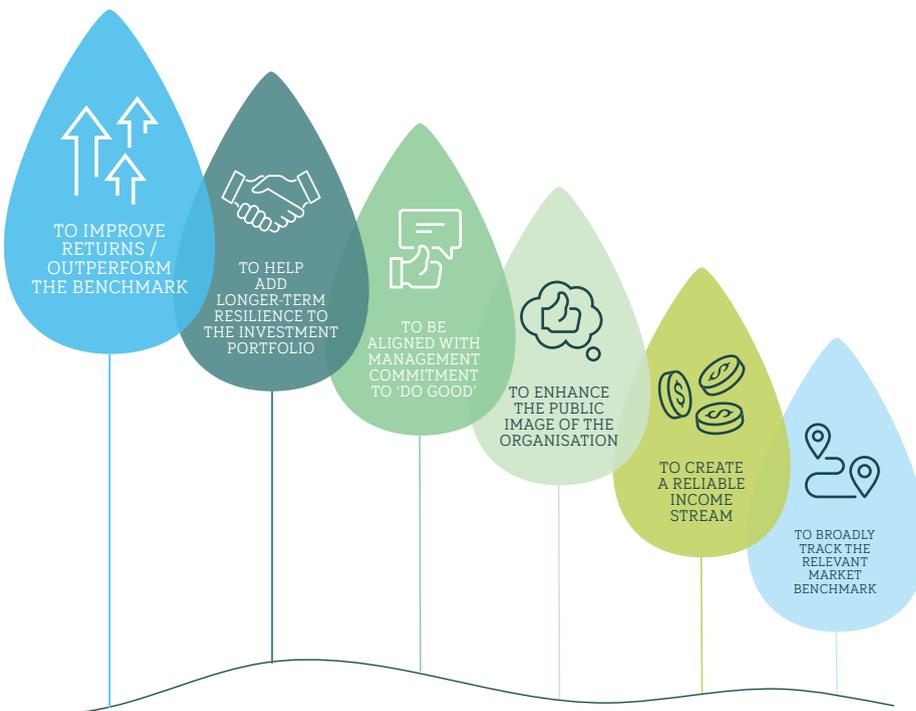
**IMPACT OF COVID-19 ON EXPOSURE TO ESG FUNDS**



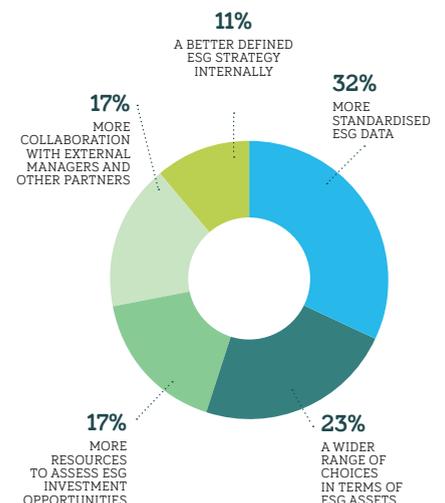
**CURRENT % OF PORTFOLIO INVESTED IN ESG-RELATED MANDATES**



**KEY DRIVERS FOR INVESTING IN LINE WITH ESG FACTORS**



**KEY CHANGE REQUIRED TO ENCOURAGE MORE ESG EXPOSURE GOING FORWARD**



ESG

their level of unpreparedness for many of the so-called ‘unknown’ risks that they should have had some sort of plan to mitigate.

In Asia, participation in the CSA has been growing steadily over the years, he adds. “This is partly also due to new index products being launched in markets like Australia and Japan, which have helped to highlight the relevance of participating in survey.” In short, companies know the results of the CSA are the basis for new ESG-focused index products that are receiving more investor attention.

**PORTFOLIO PREFERENCES**

When choosing which ESG funds to allocate to, meanwhile, many investors in the survey show a home bias.

Beyond exposure to domestic markets, North America is the geography of choice, followed by mainland Asia.

In terms of the likely preferred theme for investors in 2021, clean energy is a clear winner among respondents. Lower carbon emissions are next on the hit-list, and far more popular than the next best-ranked themes: disclosure of corporate information for transparency, medical

technology / biotechnology, and protecting shareholder interests.

This reinforces the environment as top of mind for asset owners in Asia Pacific, also in line with calls among these investors for faster climate action.

For example, the Asia Investor Group on Climate Change (AIGCC) – representing leading institutions such as AustralianSuper, Singapore’s GIC and South Korea’s National Pension Service, among others – is pushing for companies to become better prepared for the transition to a net-zero carbon economy or to meet the carbon reduction goals of the Paris climate agreement.

While climate is at the top of the agenda today for most investors, healthcare and ageing population are increasingly important themes in certain countries, such as South Korea and Japan, adds Jus. Going forward, he expects to see a sharper focus on social topics, including gender diversity, human capital and working conditions. The demand for more social investors in a post-pandemic world is expected to increase significantly.

In terms of asset classes, investors seem to be looking for support in relation to

bonds and equities to enable them to expand their ESG coverage.

However, there is also a notable requirement for more information on private equity and infrastructure. This reflects the relatively high cost of applying an ESG focus to illiquid assets in comparison with public securities, often due to the greater scrutiny required to identify risks that are typically buried in loan portfolios.

The current rate of passive ESG investing, however, is relatively low in Asia. Although more than half of survey respondents find both active and passive strategies to be equally effective in helping them find relevant ESG investments, just over one-third of the rest of the investors say they consider active strategies to be most effective. Only a handful opted for passive strategies.

**COMMON STANDARDS**

Overall, there is a long way to go to drive more meaningful ESG integration in portfolios, despite greater awareness and appetite since Covid-19 about the potential role of ESG funds.

The most important change investors say will encourage higher levels of ESG exposure going forward is more standardised ESG data, according to respondents.

This stems from growing concerns that although the volume of ESG data is growing quickly, there is no uniform methodology to quantify many ESG factors given they are dynamic in nature and defined differently across countries and regions. There are also inconsistencies in reporting and disclosure, plus issues with transparency. The need for more data on social issues and topics is especially acute.

Without a one-size-fits-all approach, investors tend to do their own bottom-up analysis combined with ESG evaluation for each company individually.

A wider range of choices in terms of ESG assets was the next major change investors say they want to see.

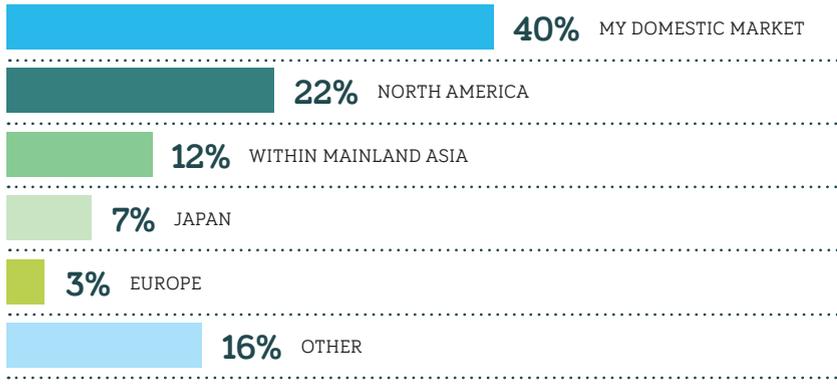
Solutions are likely to appear over time, as this space grows in maturity and sophistication. Further, international efforts by governments and agencies to agree a core set of ESG metrics, properly audited, will also be a big step in the right direction.

“There is a lot of attention on a common language for specific ESG topics,” adds Jus. “Globally, more collaboration is emerging among standard setters. This will in turn lead to more convergence of global definitions, which will also help companies and investors in Asia Pacific to adopt a

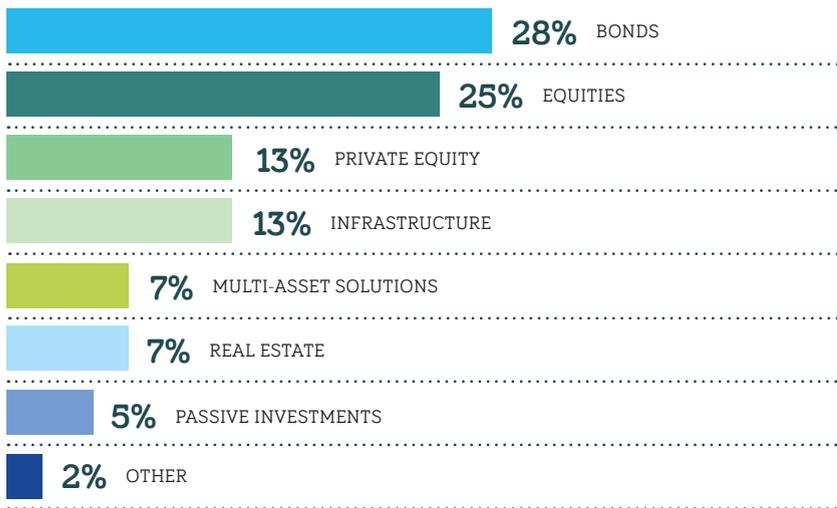
**MOST APPEALING ESG THEME FOR 2021**



**PREFERRED GEOGRAPHIC EXPOSURE WHEN ALLOCATING TO ESG FUNDS**



**PRIORITY ASSETS FOR SUPPORT TO EXPAND ESG COVERAGE**



streamlined framework to get better and more comparable data.”

**MEASURED DECISIONS**

With ESG issues playing an ever-bigger part in investment processes, it is inevitable that asset owners are more closely examining the claims and credentials of fund managers.

The majority of investors are pursuing ESG integration within their portfolio via due diligence conducted by their in-house investment committee. Collaboration with asset managers is also a popular approach.

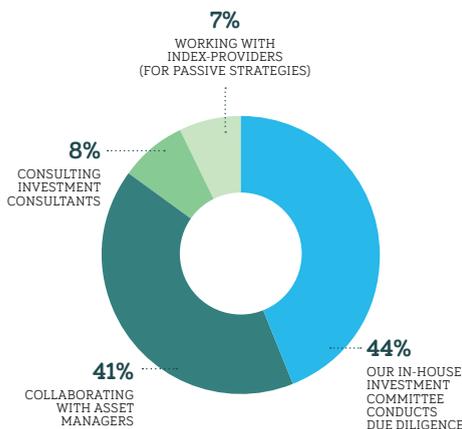
Meanwhile, the two notable preferences among investors when they assess different ESG funds are consistent with criteria that dominate decision-making with all other types of funds, namely: track record of the investment strategy; and fund performance over the benchmark.

However, the asset manager’s ESG principles are next in order of importance for investors when making investment decisions. This ranks significantly higher than the fund’s theme and fee levels.

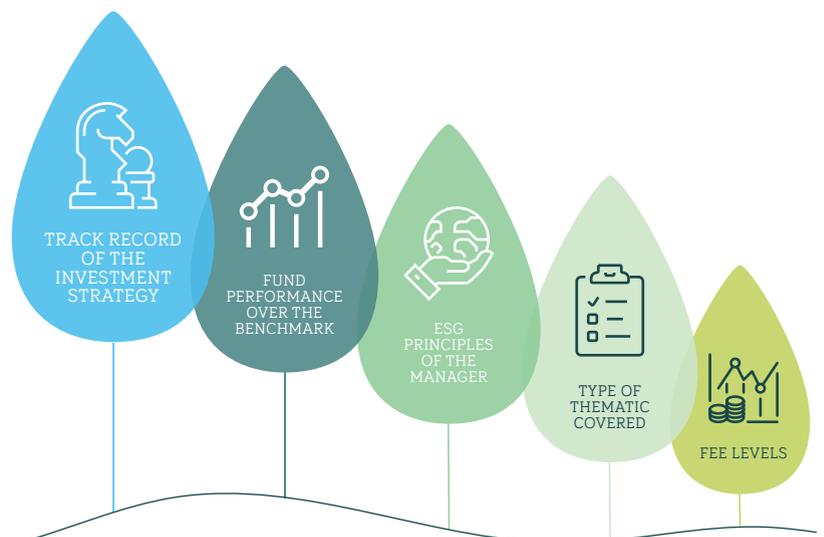
From Jus’ perspective, exclusionary and negative screening remains dominant when applying ESG principles to the investment process. However, he adds, the performance of many ESG funds since the start of the pandemic indicates that those companies which are managed more holistically have weathered the storm better than their less ESG-compliant peers.

“This adds more credibility to the narrative that investing in ESG does not come at the expense of returns, nor does it necessarily have to cost more,” says Jus.

**PRIMARY APPROACH TO ESG INTEGRATION WITHIN A PORTFOLIO**



**TOP SELECTION CRITERIA WHEN ASSESSING ESG FUNDS**



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