CFA Institute® Asia-Pacific Research Exchange

CFA Society Malaysia

WORLD BANK GROUP Inclusive Growth & Sustainable Finance Hub in Malaysia

PRACTITIONER'S BRIEF

ALL HANDS ON DECK: MALAYSIA'S STAKEHOLDERS CONVERGE ON SUSTAINABILITY MEASURES

SUSTAINABLE AND RESPONSIBLE INVESTMENT WEBINAR SERIES 2021

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EXECUTIVE SUMMARY

From its origins half-century ago, environmental, social, and governance (ESG) investing — that is, evaluating companies based on ESG considerations — has accelerated, most notably in the past few years. Climate concerns, fuelled by ever-more-intense wildfires and storms, has put the "E" in ESG front and centre.

In the past year, the global Covid-19 pandemic has brought the "S" (societal issues) to the fore. Covid-19 has exposed social inequalities. And it has accelerated trends already underway.

Companies, for instance, that did not score well in the societal category of ESG tended to experience difficulties over the past 12 months.

The pandemic lockdown, which reduced travel and reduced air pollution, led to headline-worthy clear, blue skies in some parts of India, for the first time in years. According to experts, this was a reminder of how nature can recover if given the chance.

Earlier this month, a group of key stakeholders from Malaysia's capital market regulators and institutional investors came together for an exchange of ideas. This virtual roundtable discussion on Sustainable and Responsible Investment was part of a series of 2021 webinars jointly hosted by CFA Society Malaysia and World Bank Group Inclusive Growth and Sustainable Finance Hub in Malaysia.

The main takeaway is that although there is a substantial interest in achieving best practices for sustainable investing, the evidence of actual implementation is scant. Moreover, divides exist between perceptions and reality, for example about soybean deforestation practices in the value chain. Demand for transparency far outstrips the supply of disclosures. There is also an enormous gap in funding, as trillions of dollars are going to be needed to properly address climate change.

A GREENER, COOLER EARTH REQUIRES EVERYBODY

Sustainability issues are difficult and complex. But the pandemic has been a wakeup call. How can we avoid the next pandemic-type crisis? Having a greener cooler planet is the best course — and the Malaysia financial community can do its part by pursuing and sharing best practices. All key constituents need to join together.

As Justin Ong, President, CFA Society Malaysia, said, "it's all hands on deck."

Priorities, say industry leaders, should include standardized disclosures. In his keynote remarks, Tan Sri Abdul Wahid Omar, Chairman, Bursa Malaysia, explained that the lack of uniformity makes it difficult to accurately contrast companies worth emulating from those that are falling woefully short. Too many companies have approached sustainability strictly from the standpoint of compliance only, he said, as opposed to having an all-encompassing mindset.

An all-in approach is warranted if only because of the potential upside. Sustainability initiatives represent a $12 trillion market opportunity and could result in the creation of 380 million jobs.

The post-pandemic recovery needs to be a green one for world economies to regain footing, said Dr Firas Raad, Country Manager, World Bank Group / Inclusive Growth & Sustainable Finance Hub in Malaysia.

Already the world and the workforce are changing dramatically.

TRENDS TO WATCH IN 2021

Chitra Hepburn is the Managing Director and Head of ESG for MSCI in Asia Pacific. In her presentation, which covered the big picture, Hepburn outlined some highlights of the MSCI "2021 Trends to Watch" report, including the following:

- The pandemic has redefined what it means to work in a dangerous job: industrial accidents are no longer the main focus; more concerning now are those working in proximity, such as conditions for food and beverage industry workers.
- The growth of social bonds, as a subsector of green bonds, jumped in 2020 from 5% to 15%.
- The S in ESG matters. There are consequences for having a poor "S" score. Companies that scored lowest were twice as likely to see a drawdown in share price.
- Too much crucial data remains unavailable. For instance, when it comes to disclosures relating to biodiversity (deforestation, preservation, species protection), fewer than 10% of companies included in the MSCI All Companies World Index (ACWI) Investable Market Index (IMI) disclose this data.

ESG CORRELATES TO PERFORMANCE

Studies of MSCI all-country world indexes show that companies with higher ESG scores tended to have higher valuations, as a result of higher earnings and companies taking sustainability more seriously benefitted from the inherent rewards. Regulators continue to try to exert influence externally and a combination of market forces and regulatory push is the key driver for change in most markets

Take for instance the EU regulation on sustainability-related disclosures in the financial services sector, or the Sustainable Finance Disclosure Regulation (SFDR), which goes into effect in March. The SFDR mandates disclosures requirements for banks, insurance companies, pension funds, and investment firms. It could further shift capital markets' appetites towards sustainability. Because of SFDR, companies will be required to capture data that currently are not being captured adequately. Industry members are already moving ahead.

"From where we sit, we see that companies are stepping up their game," Chitra said. "And advisors and bankers are lining up to help them."

Companies improving their ESG scores on environmental policies should be watched closely, as even incremental advances are paramount. A "least-we-can-do" approach is better than nothing. In the worst-case climate scenario, our planet will get 4°C hotter. If we do a little more than nothing, this can be reduced to an increase of 3°C. And if financial stewards really go at this problem full on (i.e., engage with companies to transform their business models, decarbonize, or divest), we could realize the best-case scenario—that is, a 1.5°C rise, which is far from ideal but not catastrophic.

Investors, asset managers, and industry members across all segments are gearing up for a new era of mainstream ESG adoption. Plans, team structures, and products are all placing ESG considerations at the forefront, according to Mary Leung, Head, Advocacy, Asia Pacific CFA Institute.

ESG FAST-BECOMING MAINSTREAM

During the session, Mary also gave highlights from a 2020 CFA Institute report, based on surveys and feedback from 7,000 stakeholders, including institutional and retail investors and industry members. The report examined the future of sustainability in investment management, which is on the rise and is fast becoming mainstream.

This research made it clear that firms will need to adapt their products and teams and, in some cases, their whole identity. Emphasis will need to be placed on education and culture, Mary explained.

Some 75% of a key retail segment (consumers ages 24 to 35 years old) surveyed said they were interested in sustainable investing. But only a small amount (no more than 20%) of respondents currently invested in such products.

Two-thirds of industry respondents said they expect the influence of ESG ratings on firms cost of capital will be greater in the next five years.

As far as industry commitment, the big question comes down to motive: why bother to take ESG issues into consideration in investment analysis decisions? In response to that question, a majority (59%) of investment professionals in the Asia Pacific region said it was to manage investment risks; indeed, risk management was the biggest driver in China, Australia, India, and Singapore.

Only in Japan did some other factor (i.e., client demand) prove to be more of a motivator.

Approaches to ESG implementation can vary. In Asia Pacific, the survey results were as follows: 52% negative screening, 39% positive screening, and 34% active engagement. The highest level of active engagement was in Australia (59%).

Two other interesting takeaways from the CFA Institute surveys and research follow:

- The rise of alternative data will make sustainability analysis more robust. Some 71% of respondents agreed with this statement.
- In evaluating ESG factors, human judgment will thrive — nearly two-thirds of respondents agreed; meanwhile, artificial intelligence got only a 43% vote of confidence. "Humans are able to contextualize data, relative to over robots," Leung said.

ESG IS A "MUST-HAVE"

For asset managers, ESG is "no longer a 'nice to have,' it is a must," said Rohaya Mohammad Yusof, CIO, Malaysia's Employees Provident Fund (EPF).

The pension fund continues to encourage managers to think more ambitiously about how to incorporate ESG into investing process. Puan Rohaya discussed the multifaceted approach to incorporating ESG into the investment decision-making process, including screening out companies, engaging proactively with companies, voting, monitoring, employing rating tools, and conducting independent risk reviews. Engaging with companies is a more effective approach compared with divestment.

Studies have shown that ESG stocks tend to show resilience in times of crisis as well as in the longer term. Among EPF's holdings, the 10 highest ESG ranked domestic stocks outperformed the 10 lowest ranked at the height of the Covid-19 pandemic in the first quarter of 2020. Similarly, the local ESG index, FTSE4Good, outperformed the FTSE Bursa Malaysia Kuala Lumpur Composite Index over one- and five-year periods.

EPF outlined several initiatives following the establishment of its Sustainable Investment Framework and Policy early this year. They include developing sectoral and issue policies to guide its investment decision-making process and engaging with the top holding domestic companies to share about its sustainability initiatives.

The Securities Commission Malaysia (SC), meanwhile, helped establish the JC3 platform, a body set up to facilitate collaborative climate-related policy actions within the Malaysia financial sector, explained Salmah Bee Mohd Mydin, Executive Director, Securities Commission Malaysia.

In addition to the SC, the JC3 also includes Bank Negara Malaysia, Bursa Malaysia, and 19 other financial industry players.

"We all understand these issues and we see asset owners coming to the fore and propelling us further in the right direction, addressing things like climate issues, but without compromising returns," Puan Salmah said.

She also agreed that standardized reporting is a priority going forward.

Among other priorities, industry members said, was the need to combat the spread of "greenwashing," which seems to be disturbingly prevalent. A company is said to be engaging in greenwashing when it overstates its commitment to sustainability. All too often, these claims go unchecked. Because of the significant interest in ESG investing, as well as the surrounding confusion and misperceptions, investors need guidance about risks, including greenwashing.

Around 78% of respondents surveyed by CFA Institute said that the industry needs improved standards surrounding ESG instruments with an eye towards diminishing greenwashing.