A new momentum for ESG in Asia

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Our Head of ESG Funds was interviewed by BL Global Magazine and a summary featured in their Asia Edition published in December 2020. Here are her full responses to questions about the rise of sustainable investment.

Sustainable investment at the top of the agenda. Can you explain why you think that's the case?

Sustainable investment has actually been around for a long time, particularly in the guise of socially responsible investing. However, there has been a crescendo of various factors coming together to bring sustainable investment to the fore, making it the hot topic it is today.

On the one hand, we have seen greater governmental commitments to sustainable development and a transition towards a low carbon economy. In particular, the adoption of the 17 Sustainable Development Goals by world leaders in September 2015 could be considered an inflection point. The SDGs laid out the blueprint for how countries and industries can design and finance sustainable development and now provide a common language for sustainability discussions. They are a framework against which investment strategies can be aligned and more generally map out of the relationship that exists between strong financial systems and long term sustainable development.

Meanwhile the call for action amongst civil society has also stepped up. A heightened focus on the threats of climate change and a renewed emphasis on corporations not just doing "best in the world" but also "best for the world" as reflected in the growth of B Corporations. Drawing the finance industry into this sphere of momentum has been largely led by investor demand and shareholder activism but also supported by the development of regulation such as TCFD and SASB.

To a large extent, this regulation has been voluntary, however, we are now just moving into a new phase of mandatory requirements. It is also helpful that there is increasing evidence that incorporating aspects of sustainability (more specifically, environmental, social and governance factors) into investment processes does not mean a sacrifice on returns and there are examples now of how this can in fact contribute to greater resilience and even better performance in some cases. These are just some of a number of factors. The upshot is that the momentum around the topic of ESG has become self-propelling as industry participants scramble to catch-up so as not to be left behind.

How does this apply to China and Asia?

In China, President Xi Jinping has pledged to achieve carbon neutrality before 2060 and to ensure China's greenhouse gas emissions peak during this next decade. Environmental issues had become a big issue in China further to its rapid industrialisation, urbanisation and population growth. Therefore the significant efforts we have seen in China has largely been driven by a very apparent need for change. Air pollution in particular has caused a lot of dissatisfaction among the populous with conditions becoming so bad that in 2014 Premier Li Keqiang declared war against air pollution. One of the major contributors to China's air pollution is its coal industry and in 2013, the Chinese government commenced a major campaign to convert coal-generated heating to gas or electric heating. In fact, it has taken a broad array of measures to protect the environment over the last decade. However, challenges remain.

More recently, a key component of China's strategy to combatting its environmental issues is the greening of its financial industry. In fact, this has become an important national development strategy and private finance has been acknowledged as a critical component of that development. The People's Bank of China has previously stated that public finance can only account for 15% of the funding required to address China's environmental problems and meet its climate goals. Therefore, private capital, whether it comes from onshore or international sources, is going to be critical to supporting the transition to a green economy in China. This reliance on private capital is a global phenomenon and this underlines the importance of the growth of sustainable finance to meet that supply gap.

Asia, with the exception of China, has been somewhat behind the pace compared to the developments in Europe but the changes are very much filtering through now.

Which financial instruments do you think are most important? Is most of the activity still around green bonds?

The main point here is that we must diversify our sustainable investment product bank beyond bonds and we are starting to see that happen. Green bonds have played a critical role in financing projects in low-carbon transport, renewable energy, green buildings, sustainable water and so. This is certainly an area where China has showcased itself. In just four years, China has become the world's second-largest issuer of green bonds after the US, raising US$31.34 billion in 2019. However, the appetite for sustainable finance goes beyond green bonds, which is very much focused on use of proceeds. For example, the 2019 IFC paper on the

Promise of Impact Investing reported that investor appetite for impact investing (a subsect of sustainable investing) is as high as $26 trillion. $21 trillion in publicly traded stocks and bonds and $5 trillion in private markets involving private equity, non-sovereign private debt, and venture capital.

In Hong Kong, the starting point has also been bonds. But in both Singapore and Hong Kong we have seen the attention turned to the financial ecosystem more generally. Earlier this year the Hong Kong Monetary Authority and the Securities and Futures Commission (**SFC**) established the Green and Sustainable Finance Cross-Agency Steering Group whose other members include the Environment Bureau, the Financial Services and the Treasury Bureau, Hong Kong Exchanges and Clearing Limited, the Insurance Authority and the Mandatory Provident Fund Schemes Authority. The purpose of the Steering Group is to co-ordinate the management of climate and environmental risks to the financial sector as well as to accelerate the growth of green and sustainable finance in Hong Kong.

The recent flurry of announcements regarding compulsory TCFD requirements for the finance industry, as seen in New Zealand and the UK, is also seen to a more limited extent in Hong Kong and Singapore. Both Hong Kong and Singapore have started a consultation process with regards to guiding the asset management industry on climate disclosures and are competitively positioning themselves as Asia's green financial centres. For example, the SFC in Hong Kong is proposing to introduce mandatory climate related disclosures for fund managers and to require them to consider climate related risks in their investment and risk management processes. This follows the implementation of the mandatory ESG requirements in the Hong Kong Listing Rules which makes reference to the recommendations made by the TCFD.

What is driving investors internationally towards sustainable products? Is it because they have a mandate (eg in the case of pension funds) to do so? Or for compliance reasons? Or do they anticipate that risk/return will actually be better than non-sustainable investments? What about HNWIs – are they motivated to invest sustainably?

It is all of the above, client demand, regulation and increased recognition that ESG factors can affect (and are increasingly likely to affect) risk and return. The driving force really depends on the type of investor. For example, within the family office space this is very much dependent on the mandate. If you are talking to a fund of funds they are very likely to be asking about ESG as they ultimately face the same questions from their own investors. HNWI have certainly been a huge driver of this demand globally as well as locally in Asia, and the expectation is that millennials will increasingly looking to invest in alignment with their values. Research reported by Standard Chartered Private Bank in 2019 found that ESG funds made up almost a fifth of Asian HNW portfolios. Further in its 2020 Sustainable Investing Review, they found that 90% of Asian HNW investors surveyed said they were interested in sustainable investments and plan to invest between 5% and 10% in this area.

What do you see as the key barriers to sustainable investment?

It is likely a combination of supply and demand hurdles but also issues around ESG data. The availability of ESG data, the reliability of that data as well as some gaps in the transparency of benchmarks and indexes has made it harder to measure and effect ESG investments. In passive investments, tracking error is a challenge to ESG incorporation, for example, where many investors are a) contractually constrained by tracking error risk or b) not willing to deviate from the market beta. Another challenge is around ESG methodologies and the fact this is still an immature field.

Finally, one of the common cited issues is that of green washing. However, with the increasing maturity of the market and increased regulation against green washing, my expectation is that this wont be considered a true hurdle for long. It is a common component of investing that one has to look beyond the pure PR so rather than green washing, the bigger hurdle at this stage is perhaps the lack of alignment on what is considered green or sustainable. Investors have to be very clear on what they are looking for and managers need to adequately disclose their approach to ESG with meaningful measurements.

What role can the Channel Islands play in sustainable investment in Asia?

As a leading international financial centre, the Channel Islands has a significant role to play in supporting the transition of capital flow to social and environmental solutions, both locally and globally. Watching from Hong Kong, it has been impressive to see Guernsey's voice in the global "sustainable finance conversation". It was the first of the jurisdictions we (Ogier) operate in to come out with a specific green fund kite mark, showing its dedication to this space and its quick footed and innovative approach.

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