

How can asset managers prepare for ESG investment, today?

ESG: Environmental, Social and Governance

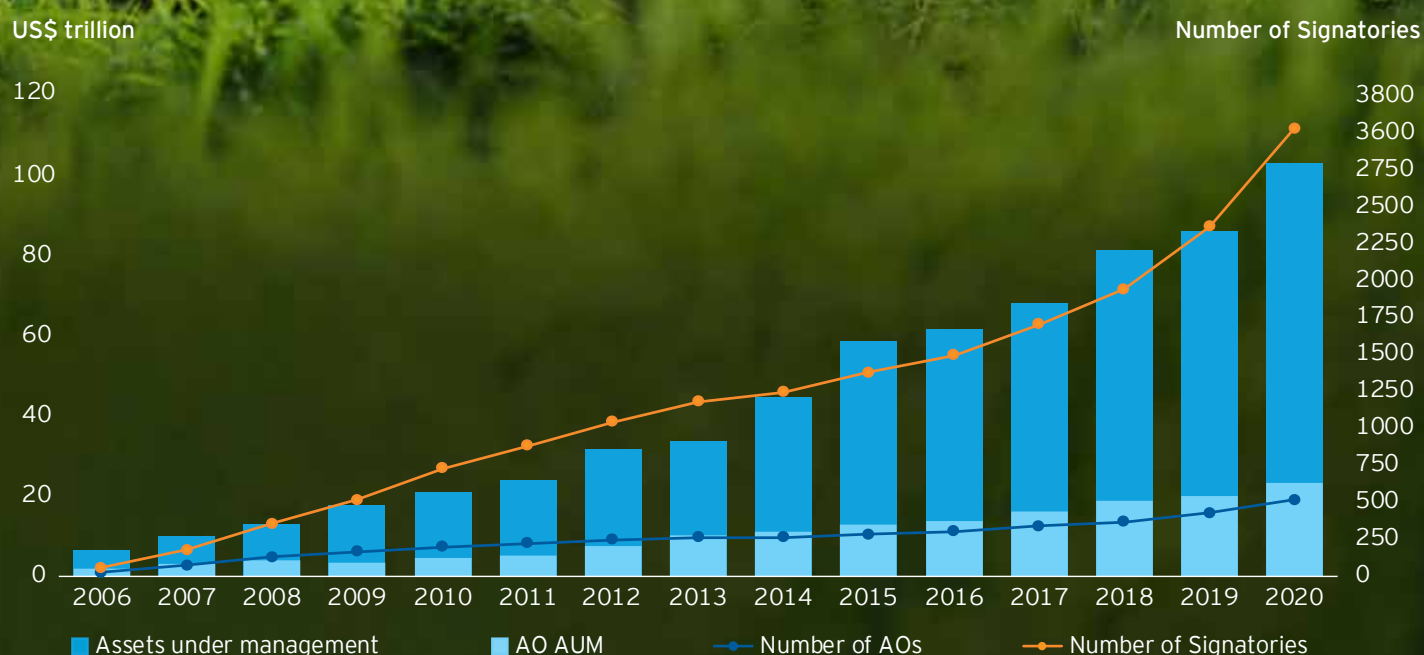
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EY

Building a better
working world

Global Environmental, Social and Governance (ESG) trends at a glance

The number of signatories for the Principles for Responsible Investment (PRI), supported by the United Nations (UN), has grown substantially since its establishment in 2006. As of December 2020, there were 3,611 signatories with assets under management (AUM) exceeding US\$103.4 trillion, of which 52 signatories were from Mainland China and 56 were institutions in Hong Kong.



Source: <https://www.unpri.org/> (dated December 2020)

*AO: Asset Owner

ESG regulation and taxonomy

Regulations for ESG information disclosure and ESG investment are intertwined and mutually enhanced. Recognition of the positive impact of ESG activities on business operations and value, as well as the increasing demand by investors for more information on how corporates manage their ESG risks, has resulted in a rapidly changing global regulatory landscape in ESG matters. Meanwhile, it is encouraging to witness that integrating ESG factors in asset management and risk management processes are gaining momentum.

Economies					
ESG information disclosure	As of 2020, Guidelines for Environmental, Social and Governance Information Disclosure of Listed Companies in Shanghai Stock Exchange is currently in its consultation phase.	In 2019, the Hong Kong Stock Exchange (HKEX) released the conclusion on its consultation paper, which further tightened the rules for ESG information for listed entities.	In 2016, the Singapore Exchange (SGX) published the Sustainability Reporting Guide, which mandates annual sustainability reporting by all listed companies on a comply-or-explain basis.	In 2017, the London Stock Exchange (LSE) issued the ESG reporting guide to encourage listed companies to publish ESG reports. In 2019, the UK Government published the Green Finance Strategy Report, which highlighted the expectations on large asset owners and all listed companies to disclose information in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations by 2022.	In April 2020, the European Council published the Taxonomy: Final report of the Technical Expert Group on Sustainable Finance which served as an EU-wide classification system for environmentally sustainable economic activities. Under the proposed Taxonomy regulation, institutional investors and asset managers marketing investment products as “environmentally sustainable” would need to explain whether, and how they have used the EU Taxonomy criteria.
ESG investment	In 2018, partnering with the City of London, Green Finance Committee(GFC) launched Green Investment Principles (GIP) for the Belt and Road Initiative (BRI). In the same year, the Insurance Asset Management Association of China (IMAC) issued the Green Investment Initiative for China Insurance Asset Management Industry. In 2019, following the Green Investment Guidelines launched in 2018, the Asset Management Association of China (AMAC) issued notice for fund managers to submit the Self-assessment Evaluation Report for the Green Investment Guidelines.	In 2019, The Securities and Futures Commission (SFC) of Hong Kong issued the Circular to Management Companies of SFC-Authorized Unit Trusts and Mutual Funds – Green or ESG Funds. In May 2020, authorities including the Hong Kong Monetary Authority (HKMA) and HKEX jointly set up Green and Sustainable Finance Cross-Agency Steering Group to accelerate the growth of green and sustainable finance. In July 2020, amendments on Hong Kong Stock Exchange's ESG Reporting Guide and related Listed Rules came into effect. In October 2020, the SFC launched a consultation on proposed requirements for fund managers to address climate-related risks of investing in funds.	In 2019, Monetary Authority of Singapore (MAS) announced US\$2billion for the Green Investment Program (GIP), and will place funds with assets managers who are committed to driving regional green efforts beyond Singapore and to managing environmental risks. In December 2020, MAS finalized the Guidelines on Environmental Risk Management for Asset Managers, Banks and Insurers. The Guidelines are intended to set out sound practices in relation to these financial institutions' governance, risk management and disclosure of environmental risk. The Guidelines were co-created with financial institutions and industry associations from the banking, insurance and asset management sectors. The Guidelines also serve as a call to action for financial institutions to support the transition to an environmentally sustainable economy, by enhancing the integration of environmental risk considerations in the financial institutions' financing and investment decisions and promoting new opportunities for green financing.	In 2020, the UK Financial Reporting Council revised the UK Stewardship Code to reflect and integrate ESG elements to guide responsible allocation, management and oversight of investment capital.	In March 2018, the European Commission released an Action Plan for Financing Sustainable Growth to reorient capital flows to ESG investments and mainstream sustainability into risk management by clarifying institutional investors and asset managers' duties regarding sustainability.

How asset managers are responding to the market and regulatory impacts of climate change and sustainability issues, especially during COVID-19

Wealth and asset managers are experiencing a time of exponential change.

In today's environment, while the world is responding to the pandemic, asset managers should rethink what they should do and how they should conduct their businesses, as we can no longer ignore the physical, market and regulatory impacts of climate change and sustainability issues.

There is a global trend for organizations to respond to the risks and opportunities related to these impacts, as well as an increasing expectation regarding the adoption of ESG-incorporated practices, from both regulated and non-regulated parties.

In order to realign and prioritize long-term value creation and gain competitive advantages in the coming years, an increasing number of asset managers are considering or have already incorporated ESG research and portfolio management into their investment process, as well as implementing ESG factors and enhancing climate risk methods within their investment due diligence process and risk management process.

By integrating ESG considerations on a holistic and fundamental basis, more information can be gained from different perspectives, by both improving protection against risks and better pricing the assets they are investing in.



Opportunities and challenges

Investors are increasingly asking whether asset managers have considered the ESG risks and whether such risks have been adequately addressed. They are assessing not only the financial performance but also the non-financial factors of the underlying investments.

According to the *2020 EY Climate Change and Sustainability Services (CCaSS) Institutional Investor survey*, 72% of investors surveyed said that they conducted a structured, methodical evaluation of non-financial disclosures – a significant jump from the 32% in 2018.

Other than the ESG disclosures, investors are looking for investments that incorporate impact investing or ESG-related factors. According to the *2019 Annual Impact Investor Survey by Global Impact Investing Network (GIIN)**, the overall impact investing AUM was estimated at US\$502 billion as of the end of 2018. Asset managers accounted for approximately 50% of the estimated AUM, reflecting the fact that investor preferences for ESG factors were becoming mainstream. Asset managers are responding to these investors' needs by offering ESG integrated funds with impact investing strategies, or by focusing on specific social or environmental theme or outcomes, such as decarbonization, high-impact disease research and greenhouse gas emissions.

*Source: https://thegiin.org/assets/GIIN_2019%20Annual%20Impact%20Investor%20Survey_webfile.pdf (dated June 2019)



To address investors' needs and concerns, asset managers are facing a number of challenges such as limited availability of data; lack of expertise on ESG issues by understanding indicators to track different strategies; difficulty in identifying if ESG factors are integrated to the core; and the cultural challenge of viewing ESG as a compliance exercise rather than a value creator.

From the regulatory perspective, regulators are continuing to expedite the implementation of ESG disclosure and benchmarking regulations during the pandemic. Also, they are being more focused on defining a consistent approach on integrating ESG-related investments into the overall investment strategy of the asset management firms, with a robust underpinning risk management framework to support such investments.

The Securities and Futures Commission (SFC) launched a consultation in October 2020 on a proposal to amend the Fund Manager Code of Conduct (FMCC) and set out baseline requirements and enhanced standards for fund managers in order to strengthen the investment and risk management and disclosure of climate-related risks. The proposed SFC requirements include fund managers to take climate-related risks into account in:

- **Governance** and management across an organization through Board's oversight, appropriate management structure, financial and human resource, internal controls, and etc;

- **Investment management** process for funds by identifying and assessing relevant and material physical and transition climate-related risks, and factoring the material climate-related risks into the investment management process;
- **Risk management** procedures by adopting appropriate steps, tools and metrics to identify, assess (and quantify), manage and monitor the relevant and material climate-related risks for each investment strategy and fund; and
- **Disclosure** in regard to Board's and management's roles and responsibilities, investment management process and risk management approach.

Enhanced standards are further proposed to Large Fund Managers*, such as adopting scenario analysis in evaluating the resilience of investment strategies to climate-related risks, identifying and disclosing weighted average carbon intensity of greenhouse gas (GHG) emissions associated with the funds' underlying investments, and disclosing relevant engagement policy.

*Fund managers with AUM of HK\$4 billion or above.

Key priorities for asset managers and other industry players

Asset management firms should look at the inclusion of ESG factors and their alignment with key regulatory expectations as a critical immediate priority. This should be done in order to understand key areas for development and to focus on implementing a strategic plan in the long term, based on the priorities identified.

Now

Understand alignment with regulatory expectations

- Strengthen ESG governance and focus on capacity building
- Conduct ESG disclosure and reporting
- Lean forward to develop exclusion lists which prohibit the investment for projects with adverse environmental and social risk

Next

Strengthen risk management framework and develop key initiatives

- ESG due diligence
- ESG risk assessment and management
- ESG investment principles

Beyond

Implement strategic initiatives to fully integrate ESG factors into the firm's value proposition and increase competitive advantage

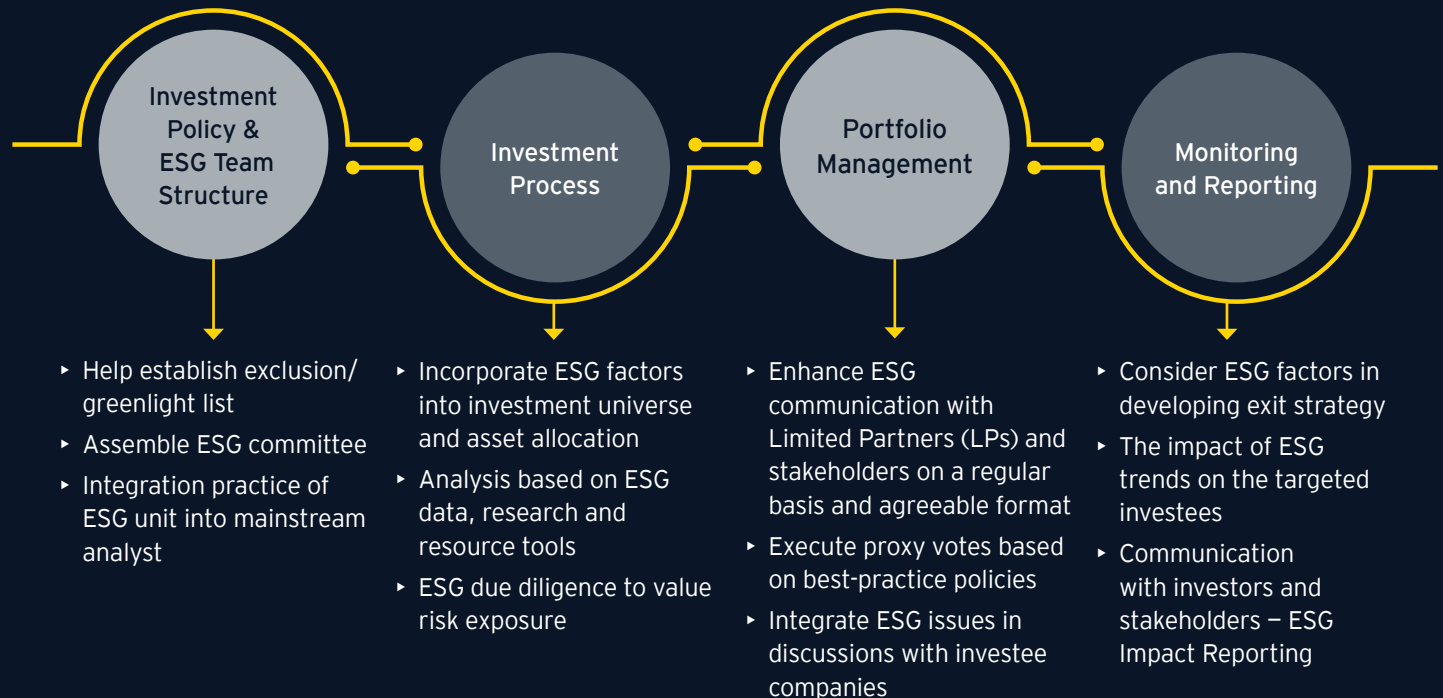
- Environmental stress testing
- ESG performance analysis
- Responsible ownership and monitoring

What services can EY teams offer asset managers?



ESG Investment Strategy Advisory

EY CCaSS team aims to provide clients with broad range process ESG investment advisory services, which are designed to help clients address emerging ESG opportunities, manage risks, reduce compliance costs, and improve operational and performance effectiveness.



ESG Performance Analysis Services

EY ESG Performance Analysis Model intends to help investors understand embedded ESG risks and opportunities. The results derived could be fed into portfolio evaluation to further support an ESG-factored investment decision process or carry out an ESG investment impact analysis.



ESG Risk Management Advisory

EY CCaSS team assists clients in the incorporation of ESG factors and in improving or developing ESG risk management systems with integrated leading consulting metrics. We have provided ESG risk advisory services for clients operating in diversified financial fields, such as banks, secondary market investors, private equity (PE) and insurance funds.

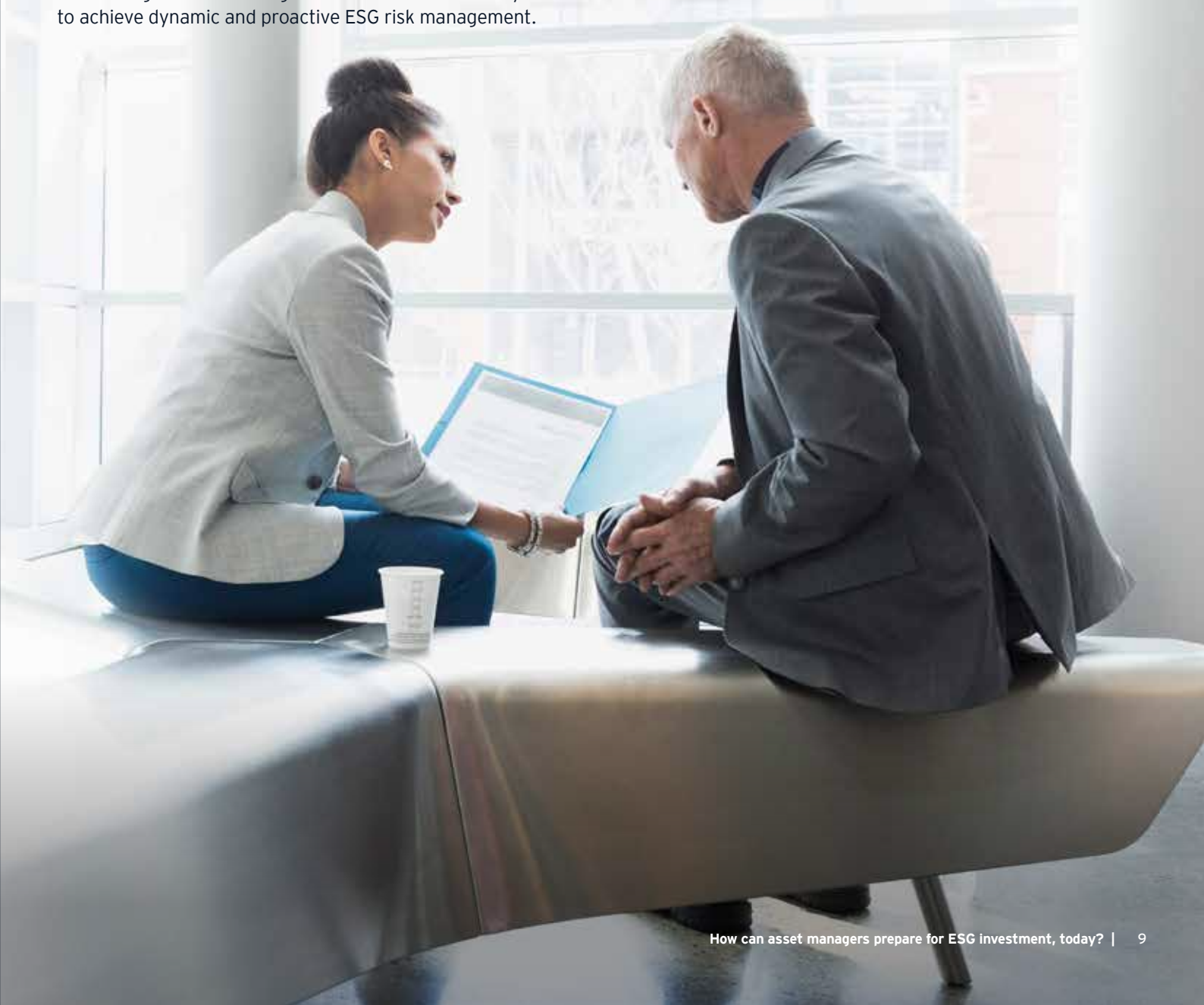
EY ESG risk management system integrates leading non-financial risk management toolboxes in the market, which include:

- ▶ Climate scenario analysis
- ▶ Environmental stress testing
- ▶ Non-financial risk profile dashboard

With the development of artificial intelligence (AI) and big data, we recommend that investors put more effort in embedding ESG risk management modules into core systems to achieve dynamic and proactive ESG risk management.

ESG Reporting Assurance and Advisory

EY CCaSS team has provided ESG and Corporate Social Responsibility (CSR) reporting and advisory services for over 300 H-share-listed companies and more than 200 A-share-listed companies, including fund houses. We assist fund managers in complying with regulatory requirements, such as performing an independent review or assurance verification on the practices and controls as a fund manager pertinent to the revised SFC's FMCC and recommend enhancement opportunities. EY consultants have participated in the consultant panel for ESG policy of Chinese capital market regulation and gain value insight for the ESG development trend in China, it is encouraging to see that the importance of non-financial performance for asset management sector is increasing in terms of regulatory requirements and investment decision-making process of investors.



Selected Credentials

ESG Investment Advisory Service for an RMB30b PE fund dedicated to the Belt and Road Initiative (BRI)

EY CCaSS team provided a detailed ESG Advisory Package for the very first ESG fund in China, ranging from ESG Investment Strategy Advisory at corporate level to the ESG Portfolio Management and ESG Investment Impact Advisory in the post-investment phase. The fund is a “domestic RMB fund plus overseas US dollar fund” and is also a dual-currency structured PE fund with a total management scale of RMB30b (equivalent).

Our services include:

- ESG Strategy Framework Advisory
- ESG Performance Analysis
- ESG Due Diligence

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ESG Investment Advisory Service for a public investment fund

EY CCaSS team helps clients develop additional ESG modules that can complement the original structure, and further improve ESG risk management and make contributions to clients' ESG information disclosure.

The team helped a public investment fund to fully leverage its ESG governance, risk management and information transparency by formulating an overarching ESG strategy, carrying out ESG performance analysis in depth on 100 stocks of 300 in the market, incorporating ESG risk factors into existing risk management framework, and enhancing ESG communication to stakeholders.

Our services include:

- ESG Strategy Framework Advisory
- Application of ESG Performance Analysis
- ESG Reporting Service



3

ESG Advisory Service for an Asset Management Company (AMC) of a large-scale insurance group

EY CCaSS team has provided advisory service for a Hong Kong-based asset management company of a large and reputed insurance group with the following value-added components:

- ESG Strategy Advisory
- ESG Risk Management Framework
- Environmental Stress Testing



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