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## It pays to be ESG-focused

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*By Ismitz Matthew De Alwis*

**There is a rising tendency among asset managers in recent times to retool their existing funds by giving those products a sustainability focus. Over the past two years, conventional asset managers in the US have repurposed some 25 existing funds by incorporating environmental, social, and governance (ESG) criteria into their investment process.**



Putnam Investments which recently reclassified its US\$4.3 bil MultiCap Growth and US\$450 mil MultiCap Value funds to becoming Putnam Sustainable Leaders and Putnam Sustainable Future respectively hopes its new sustainability approaches will improve net flows by attracting a new investor base. Looking at a bigger picture, even Norway, which is reputed to be a major oil-producing country, has managed to strike a balance between meeting high standards of ESG objectives and a steady investment return. Norway first issued guidelines for the observation and exclusion of companies from the Government Pension Fund Global in November 2004.

The guidelines include two types of criteria, one that was related to specific product types and excluded companies that produced tobacco, sold or produced weapons or military materials to certain countries, or produced weapons that violated fundamental humanitarian principles. A separate set of criteria excluded companies where there was an unacceptable risk of grossly unethical corporate conduct that contributes to serious or systematic human rights violations, serious violations of the rights of individuals in situations of war or conflict, severe environmental damage, gross corruption or other serious violations of fundamental ethical norms.

## Gaining traction

Such ESG investing trends are likely to catch up in emerging economies. There is growing evidence to suggest that ESG factors – when integrated into investment analysis and portfolio construction – may offer investors potential long-term performance advantages.

Very much associated with ESG is socially responsible investing (SRI) which goes one step further by actively eliminating or selecting investments according to specific ethical guidelines. The underlying motive could be religion, personal values or political beliefs. Last December, the Securities Commission unveiled the SRI Funds Guidelines that apply to fund products within its oversight such as unit trust funds, real estate investment trust funds, exchange-traded funds, and venture capital and private equity funds. The guidelines also introduce additional disclosure and reporting requirements that aim to encourage greater transparency in investment policies and strategies of SRI funds.



A US store for environmentally friendly products is among those that draw ESG funds

Fund managers of qualified SRI funds under these guidelines will be eligible for tax incentives as announced in the 2018 Budget. With Islamic funds being recognised as

part of the SRI universe, Malaysia is currently the largest SRI funds market in Asia ex-Japan. It has 30% share of the region's US\$52 bil fund assets.

Additionally, Malaysia is also the second largest Islamic funds market globally (by domicile) at 29% of the US\$56 bil global total asset under management (AUM). According to the Green Finance Opportunities in Asean report published by DBS Bank and the UN Environment Programme Inquiry in November 2017, demand for additional Asean green investments – a facet of ESG – is envisaged to estimate US\$3 tril between 2016 and 2030 with 60% earmarked for infrastructure.

This opportunity spells a new Asean green investment market that was 37 times the size of the global green bond market in 2016. In this regard, Malaysia's well established bond and sukuk markets are in a good position to gain from the anticipated green growth given that infrastructure represents a significant portion of the Malaysian market.

## Top 10 constituents of FTSE4GOOD Bursa Malaysia Index (as of end-February 2018)

NAME OF CONSTITUENTS	NET MARKET CAP (RM MIL)	INDEX WEIGHT
Public Bank Bhd	70,750	14.15
Tenaga Nasional Bhd	63,810	12.76
Malayan Banking Bhd	61,289	12.26
CIMB Group Holdings Bhd	45,755	9.15
Axiata Group Bhd	24,467	4.89
Petronas Chemicals Group Bhd	22,846	4.57
Sime Darby Plantation Bhd	18,836	3.77
DiGi.com Bhd	17,698	3.54
Maxis Mobile Bhd	16,156	3.23
Petronas Gas Bhd	13,646	2.73

Source: FTSE Monthly Report (February 2018)

Zooming into the equity market, the FTSE4Good Bursa Malaysia Index (or ESG index) boasts 44 constituents (originally 24 when the index was introduced in December 2014) from the top 200 Malaysian stocks in the FTSE Bursa Malaysia EMAS Index as of end-February. Designed to measure the performance of companies demonstrating strong ESG practices, the index excludes companies which manufacture tobacco; weapons systems, and components for controversial weapons (ranging from cluster munitions, anti-personnel mines, depleted uranium and chemical/biological weapons to nuclear weapons).

## Rapid growth

Given that it has fast become a norm for investors to evaluate ESG factors alongside financial data when determining their investments, sceptics should feel encouraged by the outcome of a recent study by global investment research outfit Morningstar into the performance of its Sustainability Index Family. Of its 20 indices, 16 have outperformed their non-sustainable counterparts over their life span.

Moreover, the Asia-focused Sustainability indices – Asia, Asia ex-Japan and Asia-Pacific which includes Australia, Asia-Pacific ex-Japan and broad Emerging Markets – all beat their mainstream counterparts. Further debunking the myth is having the investment landscape rewritten of late with all the players in the investment value chain shifting their focus to long-term, sustainable, risk-adjusted returns as observed by BNP Paribas Securities Services head of investment analytics and sustainability (Asia-Pacific) Madhu Gayer.

## Largest markets

This is a key global trend with worldwide responsible investment assets standing at nearly US\$23 tril as of end-2016, according to the 2016 Global Sustainable Investment Review. In Asia ex-Japan, US\$52.1 bil in assets were managed during the period using one or more sustainable investment strategies. When Shariah compliant funds are excluded, the sustainable investment assets total US\$34.2 bil. Sustainable investment assets have grown 16% between 2014 and 2016 compared with 32% from 2012 to 2014.

The largest markets for sustainable investing in Asia ex-Japan are Malaysia (30%), Hong Kong (26%), South Korea (14%) and China (14%) while China emerged the fastest growing market for sustainable investing at 105% since the start of 2014, followed by

India (104%) and Pakistan (50%). Aside from the promising statistics, current investing trends seem to point in the direction that sustainable investing could be a way to reach new demographics of investors while addressing changing investor preferences. Studies show that women and younger investors care most about sustainability. As these demographic segments gain greater control of wealth, demand for ESG-minded investments is likely to grow.

## Common ESG factors

ENVIRONMENTAL	SOCIAL	GOVERNANCE
Climate change	Capital	Board
Carbon emissions	Labour standard	Pay
Natural capital	Product liability	Ownership
Water stress	Privacy and data security	Accounting
Renewable energy	Stakeholder opposition	Corruption
Green building	Stakeholder opposition	Business ethics and fraud

Source: MSCI ESG Research

## ENDS

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## It pays to be ESG-focused



Amir Muzaimi, CEO of Kenanga

There is a rising tendency among asset managers to renege on a moral duty to invest in companies that are not sustainable. Over the past two years, conventional asset managers in the US have repositioned some of their funds by incorporating environmental, social, and governance (ESG) criteria into their investment process.

Private investments which recently reclassified the US\$4.5 billion Multi-Cap Growth and US\$4.5 billion Multi-Cap Value funds to become Sustainable Leaders and Sustainable Futures respectively, hopes its new sustainability approaches will improve not only by attracting a new investor base.

Looking at a bigger picture, even Norway, which is regarded to be a major oil-producing country, has managed to enter a balance between meeting high standards of ESG objectives and a steady investment return. Norway first limited its oil investments to the oil sector and exclusion of companies from the Government Pension Fund Global in November 2012.

The guidelines include two types of criteria, one that was related to specific product types and excluded companies that produced tobacco, oil or produced weapons or military materials to certain countries, or produced weapons that violated international humanitarian principles.

A separate set of criteria excluded companies where there



A US move for environmentally friendly products is among those that drive ESG funds

was an unacceptable risk of grossly unethical corporate conduct that contributed to serious or systematic human rights violations, serious violations of the rights of individuals in situations of war or conflict, serious environmental damage, gross corruption or other serious violations of fundamental ethical norms.

### Gaining traction

Such ESG investing funds are likely to catch up in emerging countries. There is growing evidence to suggest that ESG factors – when integrated into investment analysis and portfolio construction – may offer investors potential long-term performance advantages.

Very much associated with ESG is socially responsible investing (SRI) which goes one step further by actively divesting, or selling, investments according to specific ethical guidelines.

The underlying motive could be religious, personal values or political beliefs.

Last December, the Securities Commission unveiled the SRI

Principles Guidelines that apply to fund products within its oversight such as unit trust funds, real estate investment trust funds, exchange-traded funds, and venture capital and private equity funds. The guidelines also introduced additional disclosure and reporting requirements that aim to encourage greater transparency in investment policies and strategies of SRI funds.

Panel managers of qualified SRI funds under these guidelines will be eligible for tax incentives as announced in the 2017 budget.

With Islamic funds being recognised as part of the SRI movement, Malaysia is currently the largest SRI funds market in Asia ex-Japan, it has 70% share of the region's US\$1 billion fund assets.

Additionally, Malaysia is also the second largest Islamic funds market globally (by domicile) at 30% of the US\$4 billion global total asset under management (AUM).

According to the Green Finance Opportunities in ASEAN report published by DAC Bank and the UN Environment Programme Inquiry in November 2017, demand for additional ASEAN green investments – a facet of ESG – is estimated to be US\$1 billion between 2016 and 2020 with 10% earmarked for infrastructure. This opportunity opens a new ASEAN green investment market that was 17 times the size of the global green bond market in 2016.

In this regard, Malaysia's well-established bond and stock markets are in a good position to gain from the anticipated green growth given that infrastructure represents a significant portion of the Malaysian market.

According to the equity market, the FTSE4Good Index Malaysia Index (or ESG Index) launched in December 2014, from the top 200 Malaysian stocks in the FTSE Bursa Malaysia KLCI Index as of mid-February.

Designed to measure the performance of companies demonstrating strong ESG practices, the index excludes companies which manufacture tobacco, weapons systems, and components for controversial weapons (including from cluster munitions, anti-personnel mines, depleted uranium and chemical/biological weapons to nuclear weapons).

### Rapid growth

Given that it has fast become a norm for investors to evaluate ESG factors alongside financial data when determining their investments, experts should be encouraged by the outcome of a recent study by Global Investment Research which highlights the performance of its Sustainability Index Family. Of the 20 indices, it has outperformed their non-sustainable counterparts over their life span.

Moreover, the Asia-focused

Sustainability Index – Asia, Asia ex-Japan and Asia-Pacific which includes Australia, Asia-Pacific ex-Japan and Brazil, Emerging Markets – all beat their non-sustainable counterparts. Further delving the specific sectors, the investment landscape reveals of take-ups all the players in the investment value chain shifting their focus to long-term, sustainable, risk-adjusted returns as observed by ANZ Paribas Securities Services head of investment analysis and sustainability Asia-Pacific Marina Daye.

### Large markets

There is a big global trend with worldwide responsible investment assets standing at nearly US\$1 trillion as of mid-2016, according to the 2016 Global Sustainable Investment Review. In Asia ex-Japan, US\$1.1 billion assets were managed during the period and one or more sustainable investment strategies. When Shariah-compliant funds are included, the sustainable investment assets total US\$4.2 billion. Sustainable investment assets have grown 65% between 2014 and 2016 compared with 25% from 2012 to 2014.

The largest markets for sustainable investing in Asia are Japan (20%), South Korea (14%) and China (14%) while China emerged the fastest growing market for sustainable investing at 105% since the start of 2014, followed by India (64%) and Pakistan (35%).

Aside from the promising statistics, current investing trends seem to point in the direction that sustainable investing could be a way to reach new demographics of investors while addressing changing investor preferences.

Studies show that women and younger investors care most about sustainability. As these demographic segments gain greater control of wealth, demand for ESG-oriented investments is likely to grow.

**Amir Muzaimi** is the Executive Director and CEO of Kenanga Investors and also current President of the Financial Planning Association of Malaysia (FPAM).

### Top 10 constituents of FTSE4Good Bursa Malaysia Index (as of end-February 2018)

NAME OF CONSTITUENTS	MARKET CAP (RM MIL.)	P E RATIO
Public Bank Ltd	232.10	14.75
Maybank Ltd	151.80	12.75
Malayan Banking Ltd	151.80	12.75
Chong Hing Holdings Ltd	45.75	9.75
Amara Group Ltd	24.40	6.75
Permodalan Nasional Group Ltd	22.80	6.75
Sime Darby Plantation Ltd	18.80	5.75
DiSCOM Ltd	17.60	5.50
Malayan Airline Ltd	16.40	5.25
Permodalan Gas Ltd	15.60	4.75

Source: FTSE4Good Report (February 2018)

### Common ESG factors

ENVIRONMENTAL	SOCIAL	GOVERNANCE
Climate change	Capital	Board
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Natural capital	Product liability	Ownership
Water access	Privacy and data security	Accounting
Renewable energy	Stakeholder engagement	Corruption
Green building	Stakeholder engagement	Business ethics and Fraud

Source: MSCI Research