

The Global Context for ESG Investing

Considering ESG (environmental, social and governance) factors has become an important part of mainstream investment decision making. Across the globe, asset owners and managers of all sizes and strategies have chosen to incorporate ESG criteria into their investment decision making processes. As the Global Sustainable Investment Alliance reports that approximately US\$30.7 trillion dollars of investment is now managed according to ESG investment strategies, it is clear that ESG factors are also driving asset allocation decisions.¹ Investors often cite risk management against negative externalities as a key driver in choosing to implement a responsible investment approach. In addition to making a positive contribution to the societies in which they operate, companies with good ESG performance are often considered to have lower levels of risk than those which have not taken steps to mitigate material ESG risks. In emerging markets in particular, strong performance on ESG criteria is often seen as an indicator of quality factors and good management.

FTSE Russell’s transparent and objective approach to ESG scores

FTSE Russell’s ESG Data Model produces Ratings that are an objective measure of ESG Exposure and performance in multiple dimensions. The ESG Ratings are a useful tool for investors with a need for flexible, data driven solutions that can easily integrate with investment processes.

FTSE Russell’s methodology analyses companies’ exposure across a full spectrum of material ESG risks, classified into 14 ESG themes and underpinned by more than three hundred detailed quantitative and qualitative indicators. The starting point for this analysis is an understanding of the specific risks faced by individual

companies to provide a basis for analysis of how companies are managing these risks.

FTSE Russell’s analysts take a ‘bottom up’ approach, by identifying the level of ESG risk faced by companies and assessing these against detailed indicators to see whether companies have disclosed steps taken in mitigation. An Exposure score is awarded on a range of 0-3 which represents the level of risk the company faces for each of the 14 ESG themes. This is combined with an assessment of disclosed actions the company has taken to mitigate the risk on a scale of 0-5. The Exposure score and the Performance score are computed to form an Exposure weighted ESG rating.

Chart 1: FTSE Russell ESG Ratings



*Source: FTSE Russell
Companies are assessed on issues relevant to 14 ESG themes include social and environmental supply chain.*

It is important that companies that are more exposed to particular risks from specific ESG themes are doing more to address them. Therefore higher Exposure companies are assessed using higher thresholds than lower Exposure companies.

¹ http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf

FTSE Russell provides ESG ratings for approximately 260 companies listed on the Bursa Malaysia Main Markets. The ESG ratings measure of the overall quality of a company’s management of ESG issues. Companies are assessed according to a transparent and objective methodology which considers both the level of material ESG risk they face relative to their business operations; and publicly disclosed actions taken to manage the relevant risks. Ratings are calculated using an Exposure-weighted average, meaning that the most material ESG issues are given the most weight when determining a company’s ESG rating.

Companies in the Bursa Malaysia EMAS universe with an ESG score exceeding a defined threshold² are eligible for inclusion in the FTE4Good Bursa Malaysia Index which has been screened to identify Malaysian companies with recognised ESG practices.

The ratings for Malaysian companies are displayed in quintiles, to enable investors to identify those companies which score highly on FTSE Russell’s ESG ratings. As Bursa Malaysia’s index partner, FTSE Russell is committed to help promoting sustainable investment opportunities in the region.

ESG scores for Malaysian Companies

Since the FTSE4Good Bursa Malaysia index was launched in 2014, Malaysian companies eligible for inclusion in the FTSE4Good Bursa Malaysia have increased year on year. This indicates that the ESG scores of Malaysian companies has shown consistent improvement over time. In the area of corporate governance, Malaysian companies demonstrate some of the highest levels of performance in relation to other companies operating in Emerging Markets and in term of overall ESG ratings,

² The threshold score for eligibility to FTSE4Good index series is 2.9 for companies in emerging markets and 3.3 for companies in developed markets, as at 24 December 2019. The threshold level for eligibility changes from time to time.

ranked 5th out of 16 Emerging Market countries in FTSE Emerging company scores.³ Details refer to chart 3.

In addition, the FTSE4Good Bursa Malaysia index is also open to small cap companies in the EMAS benchmark universe. Whilst small cap companies often perform less well on ESG metrics than large caps, approximately 17 of the constituents in the index are small caps, indicating a good knowledge of ESG principles among Malaysian corporates.

Chart 2: Number of Malaysian companies in the FTSE4Good Bursa Malaysia Index

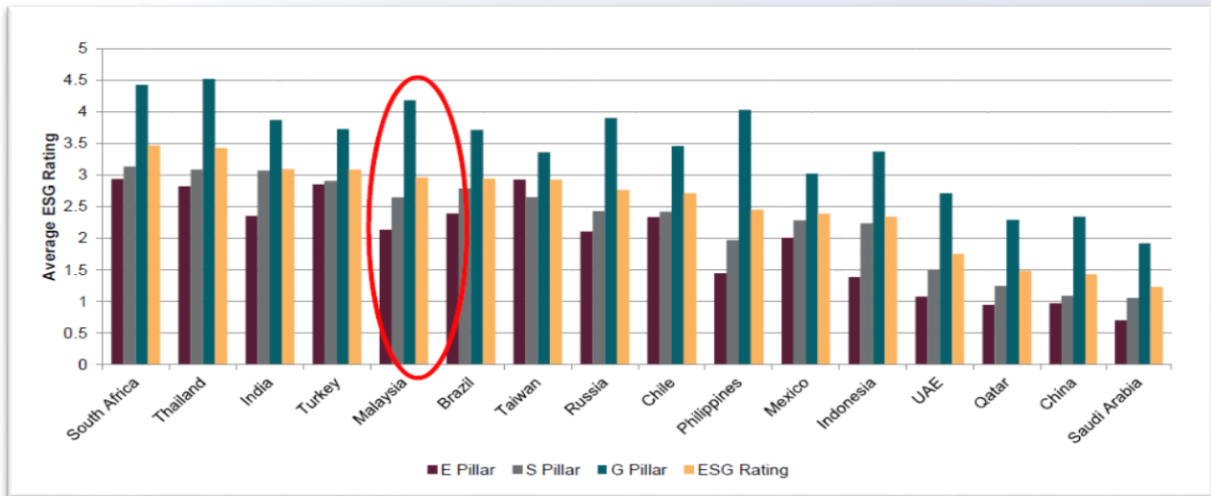


Corporate Communication in the ESG ratings process

An important part of FTSE Russell’s ESG rating process is the corporate communication programme. After companies have been assessed, in the ESG ratings process, FTSE Russell’s analysts communicate with companies to invite them to log in to a dedicated web based tool where they can view the scores and collected data, within a four week time frame. FTSE Russell have a dedicated team who will engage with issuers to discuss their ESG score and the ESG rating methodology.

³ Based on FTSE Russell analysis of companies ESG ratings in the FTSE GEIS All World Index, as at December 2019.

Chart 3: ESG Ratings for Malaysian Companies



Based on FTSE Emerging company scores as at December 2019

Relevant links

Further information on FTSE Russell’s ESG ratings methodology can be accessed here:

<https://www.ftserussell.com/data/sustainability-and-esg-data/esg-ratings>

Information on the FTSE4Good Bursa Malaysia index can be accessed here:

<https://research.ftserussell.com/Analytics/FactSheets/temp/ab976d31-9877-41f0-a9e2-0ac81d858be5.pdf>

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