BURSA MALAYSIA:

Moving the dial on ESG adoption

The Covid-19 pandemic has thrust the concept of environmental, social and corporate governance (ESG) into the spotlight as companies worldwide realise the need to adopt more sustainable practices to avoid the risk of being financially impacted in the long run.

This is also the case as ESG considerations are increasingly being integrated into decision-making at the institutional investor level, putting pressure on companies to take heed of the requirement.

The world's largest asset manager BlackRock Inc recently made a case for change when it announced to clients that companies will need to disclose their plans on what they are doing to fight climate change using scientifically established guidelines.

The firm's CEO, Larry Fink, also asked companies to disclose business plans that will be compatible with a "net-zero economy", where companies emit no more carbon than they remove from the atmosphere, by 2050, to help keep global warming under 2°C — a goal set forth in the Paris Climate Agreement.

In Malaysia, there is growing acceptance and acknowledgement by industry leaders of the need for stronger ESG adoption. In fact, the country's largest pension fund, the Employees Provident Fund (EPF), recently launched its sustainable investment policy and announced it aims to have a fully ESG-compliant portfolio by 2030.

"We aim to be a climate-neutral portfolio by 2050, with net-zero greenhouse gas emissions," says EPF CEO Tunku Alizakri Raja Muhammad Alias during a recent virtual ESG Roundtable organised by Bursa Malaysia and FTSE Russell.

The roundtable featured several industry leaders who called for stronger ESG practices to be embedded into businesses as well as having meaningful and uniform sustainability disclosures in place to help investors formulate their ESG investment strategies. Besides Tunku Alizakri, the panel was made up of Bursa CEO Datuk Umar Swift, Aberdeen Standard Islamic Investments (Malaysia) Sdn Bhd CEO Gerald Ambrose, Kenanga Investors Bhd CEO Ismitz Matthew De Alwis and London Stock Exchange Group & FTSE Russell's Group Head of Sustainable Business David Harris.

Helena Fung, FTSE Russell's Head of Sustainable Investment, APAC, who moderated the discussions, notes that sustainable investing is a critical topic that is becoming core to the way asset allocation and investment decisions are being made by investors on a global basis.

She says the financial group has seen sustainable investing strategies and companies with strong ESG credentials offer performance and resilience in the face of market turbulence caused by the global pandemic.

"From our research into the green economy, this is a growing space that accounts for US$4 trillion (RM16.2 trillion) worth of market capitalisation, while the fossil fuel index is by contrast, contracting," she says.

The risks and opportunities associated with climate change and sustainability, she adds, have emerged as important drivers of capital redirection globally as investors look to companies that are better at managing ESG risks and contribute to a low-carbon economy.

Datuk Umar observes that there is now a real call to action that was not there before. And more than playing a regulatory role, Bursa wants to facilitate the market to reward good behaviour.

"Previously when we talk of ESG, it sounded like a nebulous idea. But now it's real. We see the FTSE4Good Bursa Malaysia Index growing. We see sustainable assets outperforming. So now you have a call to action that we need to take forward," he says.

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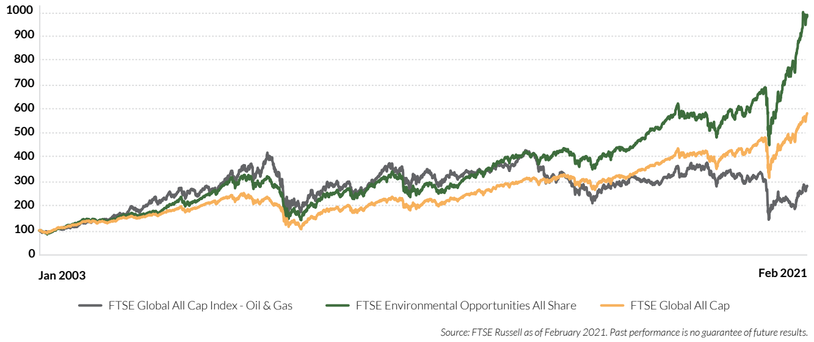
> ***— Datuk Umar Swift, CEO of Bursa Malaysia***

FTSE's green industries index, the FTSE Environmental Opportunities All Share Index, has delivered returns of 765% since 2003. That compares with returns of under 500% for global equity markets.

Performance of FTSE Environmental Opportunities All Share vs Global All Cap and Oil & Gas



Source: FTSE Russell as of February 2021. Past performance is no guarantee of future results.

Now a global agenda, the ESG investing scene is rapidly evolving

Although the concept of ESG investing or environmental, social and corporate governance has long been around, there has not been universal recognition until recently.

The agenda is now being driven by the largest asset owners around the world, notes David Harris, London Stock Exchange Group & FTSE Russell's Group Head of Sustainable Business.

He adds that Bursa Malaysia has been committed to working with the London Stock Exchange Group & FTSE Russell in improving sustainability reporting standards, which will bode well for ESG adoption in Malaysia.

"I am delighted to know that Bursa Malaysia is working with us on this. We now have a coalition of exchanges that are trying to accelerate climate reporting," Harris says during a recent virtual ESG Roundtable organised by Bursa Malaysia and FTSE Russell.

Employees Provident Fund CEO Tunku Alizakri Raja Muhammad Alias believes Bursa Malaysia, as the country's stock exchange, should take the opportunity to drive ESG adoption regionally.

"Bursa should take the lead as the ESG exchange for Southeast Asia. I think it's great for them to work with FTSE Russell to give the Southeast Asian perspective so we can start taking ownership of our future," he says.

Reflecting on how the ESG scene has evolved in Malaysia, Kenanga Investors Bhd CEO Ismitz Matthew De Alwis says just two years ago, the topic would probably come up only by the 10th conversation the firm had with its clients. But now, it is all that people in the investing fraternity talk about.

"In Malaysia, despite a slow start, the Covid-19 pandemic has actually accelerated the demand for ESG in investing. Especially because an ESG focus [helps one's investment] become more resilient in the uncertain market conditions caused by the pandemic," he says.

This is reflected in increased awareness, acceptance and application of ESG in business, he adds, while the legislative landscape has also evolved over the past few years. This includes the introduction of anti-corruption legislation and the requirements to submit sustainability information.

"Amid the Covid-19 crisis, we start to see society focusing more on the health and safety of employees. Until now, social factors were considered to have a relatively small impact on stock prices and corporate values, compared with environment- and governance-related matters. But this view is gradually changing, as there is significant implication to the investing landscape.

"There is now more attention towards tackling social issues, such as public health, human capital management and societal inequalities. So in Malaysia, we expect that if companies promote environmental protection, employee welfare and women's participation, for example, their corporate value will increase, spurring economic growth in a virtuous cycle," De Alwis says.

The Institutional Investors Council Malaysia (IIC) is also expected to play a pivotal role in spearheading this change, says Aberdeen Standard Islamic Investments (Malaysia) Sdn Bhd CEO Gerald Ambrose.

Ambrose, who is a board member of the council, says the IIC was set up to drive institutional governance but there is clear evidence that it also has a role to play in helping to improve climate management in Malaysia.

"We can see the demand is there for governance and investing in companies that would make the world better. That is why the IIC, which was started on a governance basis, is starting to look more at the social and climate change side of things."

From an international perspective, the US' climate change agenda is going to be in focus this year given the recent change in administration, Harris notes. "The 2021 United Nations Climate Change Conference (COP 26) that will be held in Glasgow is a big deal. While COP 21 talked about keeping global temperature increases around 2°C or even less, COP 26 will focus on achieving net-zero emission levels," he says.

The challenges and risks to overcome in the ESG space

While global investors warm up to the idea of adopting ESG, or environmental, social and corporate governance, practices, the lack of proper disclosure and data standardisation will pose a challenge to this development. The panellists at the recent virtual ESG Roundtable organised by Bursa Malaysia and FTSE Russell share their views on the hurdles that those in Malaysia and the world will have to address in order to achieve uniform standards.

Tunku Alizakri Raja Muhammad Alias, CEO of Employees Provident Fund

From the EPF perspective, we identify three key risks in relation to ESG — climate physical risk, transition risk and the weaponisation of ESG.

Climate physical risk — where companies don't take into account or are not aware of the impact of climate change to physical assets. For example, with rising sea levels, if we were to look at our highways, the majority of them could be underwater. This is also true for plantations near the coast, where a significant amount of plantation could be lost to the sea.

Transition risk — where companies will have to invest in more sustainable technology to make the shift towards a low-carbon economy.

Weaponisation of ESG — this is a term we coined at EPF where we are seeing some nations using ESG as a form of trade barrier or punishment of companies.

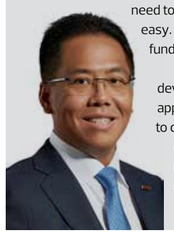
Gerald Ambrose, CEO of Aberdeen Standard Islamic Investments (Malaysia) Sdn Bhd

You can't be too prescriptive in setting standards or publishing various data in your annual report. A plantation company is very different from a gaming company, which is also different from a bank, for example. Some of the measured data that is required might be hard to achieve for a smaller company. I think everybody is slowly getting on board and agreeing that it has to happen, but they have limited budgets and capabilities to do it, so it has to be a gradual process.

ESG is extremely important to companies' financial future, so we have to look at companies from this aspect. A lot of companies we visit here in Malaysia and elsewhere in Southeast Asia want to go along with it, so through engagements with fund managers, we can help each other to get the best results for our clients.

Ismitz Matthew De Alwis, CEO of Kenanga Investors Bhd

ESG investment could be crucial for supporting sustainable growth in the country, but there are several challenges, such as unclear and dispersed criteria for sustainable investment. One of the other problems is to ensure the quality and accuracy of the information. For financial information, it is fine, as there are auditing firms that can audit it. But for non-financial data, it is not endorsed by third parties. The rules for standardisation here vary. Disclosure rules need to be developed, and it is not easy. Another discussion among fund managers is that the criteria for ESG have been developed in EU countries, so applying uniform standards to countries with differing economic standards could result in the misallocation of our economic resources.



David Harris, Group Head of Sustainable Business, London Stock Exchange Group & FTSE Russell

The momentum we are seeing on sustainable investing is phenomenal. We are seeing a gradual focus on sustainable investments over the last couple of years. What we are seeing is that this is being driven by the largest asset owners around the world. Many of us have been calling for the International Organization of Securities Commissions (IOSCO) and the International Financial Reporting Standards (IFRS) Foundation to get engaged on sustainability data standards. They are doing that now. What we are seeing are several different forces coming together to help in the standardisation of ESG data, and that's going to make a real difference because we need global, consistent real data. We hear it from investors. We also hear it from issuers because frankly, it's confusing for them and difficult to navigate with all these different standards around the world.

But we are seeing these forces coming together and what we need is for all of us to collaborate and work together. Exchange collaboration is also really important to harmonise and get consistency and prevent regional fragmentation around standards.

More importantly, companies should work with institutions and fund managers to define what they need to make better-informed decisions, he adds. "As you engage business owners, [you will see that] they are not seeing these risks. One of the roles we play at Bursa for fund managers and institutional investors is to share with them [things like], 'Here, these are real risks that you can actually see impacting share prices'."

The exchange is also mindful of not being seen as just promoting mere compliance, says Datuk Umar, as it wants the ESG focus to be inculcated in stakeholders. "When we send the message that institutional investors, markets and consumers have an expectation, good conduct will be rewarded," he adds.

He also notes that the larger public listed companies have already embraced sustainability. "It's the LEAP market perhaps, where there are growth opportunities and the benefits of sustainability have yet to accrue," he adds.

EPF's Tunku Alizakri, meanwhile, acknowledges that ESG is a real business concern. Citing a survey done by the fund in 2018, he says it found that 78% of its members do look at ESG when they evaluate their investments. "So, we want to show that we are investing in areas that are important to our members," he points out, adding that companies should focus on the social dividends of ESG besides the financial aspect.

"The Gen Y and Gen Z groups will make up 73% of our demographic base by 2025. If we don't start aligning our asset base with what they want, they may say EPF has no relevance to them any more," he adds.