

Overview

Environmental, Social and Governance (ESG) investing is one of the fastest-growing trends in the investment community over the past few years. ESG is slowly becoming a key consideration for investors. Asset owners such as pension funds are increasingly demanding sustainable investing strategies from their asset managers, and

According to IHS Markit's filings up to 7 February 2022, there were 235 ESG-mandated funds globally that were invested in Bursa Malaysia as an exchange with a total holding value of USD 143.5 billion. Figure 1 shows the breakdown of funds with ESG mandate invested in Bursa Malaysia by region. In the chart below, 44% of the total funds (excluding Malaysia) were from North America, followed by Europe at 27%. Asia came close at 26% and Middle East at 3%.

Figure 1: Breakdown of Foreign ESG Funds (excluding Malaysia) Invested in Bursa Malaysia by Region

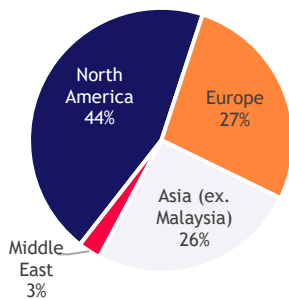
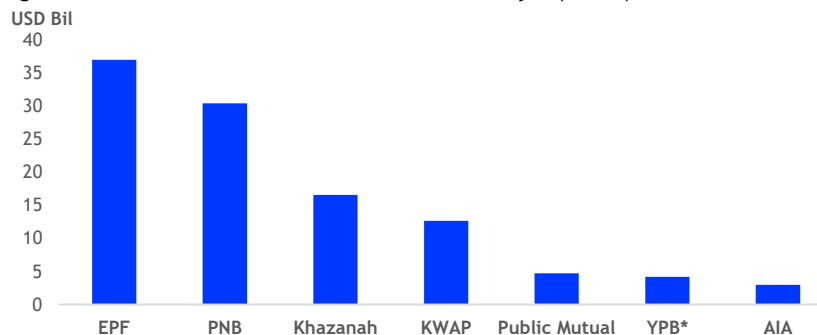


Figure 2: Local ESG Mandated Funds Invested in Bursa Malaysia (USD Bil)



* YPB refers to Yayasan Pelaburan Bumiputera; This is based on the aggregated holding value of good ESG rating stocks within the fund

Source: IHS Markit

In Malaysia, local institutions place emphasis on the importance of ESG Investments. Our key institutional investment managers and asset owners such as Employers Provident Fund (EPF), Khazanah Nasional and Retirement Fund (Incorporated) (KWAP) have participated and signed the United Nations Principles for Responsible Investment (UN PRI) in 2019. These institutions have incorporated ESG mandate into their funds. EPF is also expected to announce a sector sustainability policy framework as guidance for its future investment that will comply with ESG practices.

The local ESG mandated funds have a total holding value of USD 118 billion in stocks with good ESG ratings based on the IHS Markit's filings up to 7 February 2022. These seven fund houses ranked the highest in terms of the total holding value of stocks with good ESG ratings and accounted for 92% of the total holding value in the stocks (refer to Figure 2).

With the change in investment fundamentals within the industry, large scale investment banks are also pivoting their strategies in tandem with the rise of sustainability consciousness. [In December last year, Maybank Investment Banking Group announced that it would prioritise ESG and to help its clients to identify green opportunities.](#)

The Malaysian Gold Standard: The FTSE4Good Bursa Malaysia Index

The FTSE4Good Bursa Malaysia Index was launched in 2014 in partnership with FTSE Russell, comprises companies that demonstrate strong ESG practices. It is governed by the FTSE4Good Committee and companies are chosen based on the ESG model developed by FTSE.

Key characteristics of FTSE Russell's ESG ratings are:

- It measures the overall quality of companies' management of relevant ESG issues;
- It has >300 indicators underpin assessment against 14 different ESG themes;

- The applicability of ESG themes is determined by multi-subsector business characteristics and exposure is adjusted by country of operation;
- It is aligned with international standards and examined by an independent committee;
- It is high in transparency as it uses public information only and it has high reproducibility in calculation; and
- It is assessed based on a semi-annual review cycle.

The FTSE Russell’s ESG ratings are consistent with international frameworks. Example illustrated below.

Figure 3: FTSE Russell’s ESG Ratings Framework

Environment		Social		Governance	
Climate Change	CDP, EU Emission Standards SEC Rules for Reserves Reporting	Health and Safety	Global Business Coalition for Health/ IAEA, BSI	Anti-corruption	Transparency International World Bank, UNGC 10
Water Security	CDP – Water Program CEO Water Mandate	Labour Standards	UN Global Compact ILO Core Conventions	Tax Transparency	Action Aid Tax Guide for Investors Fair Tax Mark
Biodiversity	TEEB – The Economics of Ecosystems & Biodiversity	Human Rights and Community	Corporate Human Rights Benchmark; UN Guiding Principles on Business and Human Rights	Risk Management	Salz Review Institute for Risk Management
Pollution and Resources	ISO14001 EMAS	Customer Responsibility	Access to Medicine/ Nutrition CFA Lending Code	Corporate Governance	OECD Principles of Corporate Governance, ICGN, FRC
Supply Chain Environment	GRESB, BREEAM, SEDEX, RSPO	Supply Chain Social	PRI, PSI, Equator Principles GRESB, SEDEX, ETI		

Source: FTSE Russell

Selection methodology

The stock universe starts with the FTSE Bursa Malaysia EMAS Index, where the public listed companies (PLCs) will be assessed based on FTSE4Good Rating model. Each PLC will be given an ESG score of 0 to 5. PLCs which fall under the manufacturing of tobacco, weapons systems, controversial weapons and coal will be excluded. Companies with exposure to significant controversies will be excluded as well.

The ESG inclusion criteria includes (1) an ESG score of 2.9 and above, (2) no zero score in any applicable High Exposure ESG themes and (3) a minimum climate change score of 1, and for carbon intensive sector such as energy, utilities, heavy construction, airline sector with a required score of 3.

The ESG rating breaks down into three pillar scores namely Environmental (E), Social (S) and Governance (G), out of which, is formed by 14 thematic scores and is further broken into >300 indicators.

Assessment process of ESG ratings:

Step 1: Analyse the characteristics of a company i.e. subsector, country of operation and company status.

Step 2: With subsector and country of operation information, identify which ESG Theme has potential risks to the company and then set Exposure with 4 different levels from 0 to 3 for each applicable ESG theme.

Step 3: Assessment of actions taken against each Exposure with 6 different Scores from 0 to 5 for each applicable ESG theme.

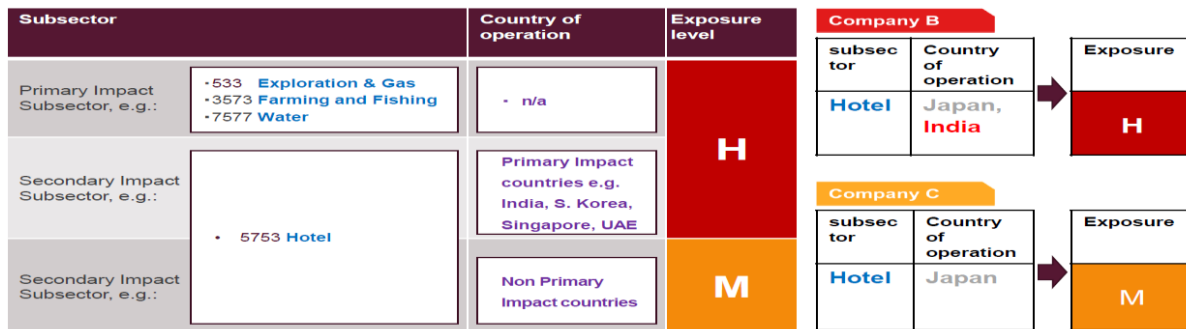
Step 4: Calculate a ESG rating with Exposures and Scores for each applicable ESG Theme.

Take Water Security theme as an example.

Step 1: Analyse the characteristics of Company B and C. Company B belongs to the Hotel subsector and operates in Japan and India. Company C is in the same subsector with Company B but operates only in Japan.

Step 2: Company B's subsector scores a 2 (Medium) on Exposure but because it has operations in India (Primary Impact Country), it is scored at level 3 (High) on Exposure for the location. Meanwhile, Company C scores a 2 (Medium) for water security theme.

For clearer illustration, see diagram below:



Source: FTSE Russell

Step 3: Assess the actions taken against water security theme by each company. There is a total of 4 indicators under water security theme. As illustrated below, 50% indicator points is awarded to Company B while Company C is awarded 66.7%. This gives them a score of 3 (Good Practice) and 5 (Best Practice) for Company B and C respectively.

Company B (High Exposure)				
Indicator legend	Indicator description	Exposure	Max possible points	Points awarded
EWT13	Water use policy	H M	2	2
EWT24	Water management plan	H M	2	2
EWT32	Water withdrawal data	H M	2	0
EWT07	Independent verification	H	2	0
Total			8	4
% of indicator points awarded				4/8=50%

Company C (Mid Exposure)				
Indicator legend	Indicator description	Exposure	Max possible points	Points awarded
EWT13	Water use policy	H M	2	2
EWT24	Water management plan	H M	2	2
EWT32	Water withdrawal data	H M	2	0
EWT07	Independent verification	H—	n/a	n/a
Total			6	4
% of indicator points awarded				4/6=66.7%

Score	Exposure		
	Low	Mid	High
0	N/A	0%	0%
1	0–5%	1–5%	1–10%
2	6–10%	6–20%	11–30%
3	11–30%	21–40%	31–50%
4	31–50%	41–60%	51–70%
5	51–100%	61–100%	71–100%

Indicator Legend	Indicator
EWT13	Policy or commitment on water use reduction which: a. Addresses the issue b. Includes commitment to reduce water use or improve efficiency

Points are assigned and are generally 0, 1, or 2 per indicator:
 > 0 point = no disclosure nor action
 > 1 point = disclose a)
 > 2 points = disclose b)

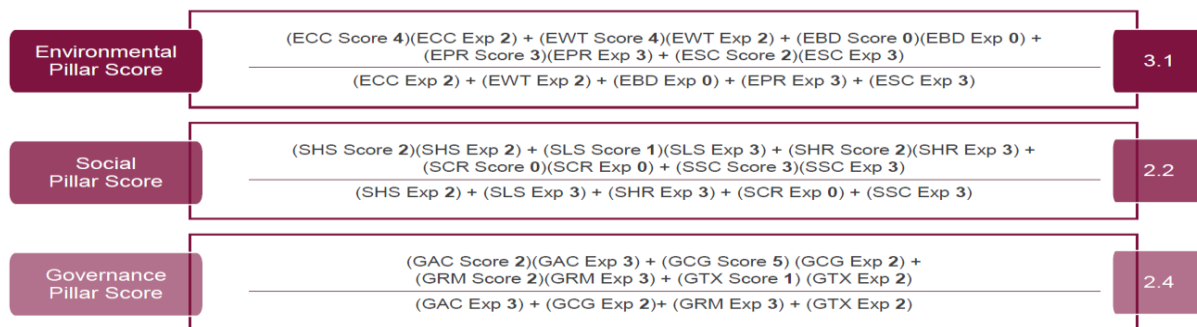
Source: FTSE Russell

Step 4: ESG rating will be calculated with Exposures and Scores for each applicable ESG Theme.

ESG Theme	Legend	Exposure (H, M, L, n/a)	Evaluation (%)	Score (0-5)
Biodiversity	EBD	n/a(0)	n/a	n/a(0)
Water Security	EWT	H(3)	50%	3
Supply Chain : Environment	ESC	H(3)	35%	3
Pollution and Resources	EPR	H(3)	58%	4
Climate Change	ECC	M(2)	17%	2
Supply Chain : Social	SSC	H(3)	43%	3
Human Rights and Community	SHR	M(2)	3%	1
Labor Standards	SLS	H(3)	12%	2
Customer Responsibility	SCR	n/a(0)	n/a	n/a(0)
Health and Safety	SHS	n/a(0)	n/a	n/a(0)
Risk Management	GRM	n/a(0)	n/a	n/a(0)
Tax Transparency	GTX	M(2)	9%	1
Corporate Governance	GCG	M(2)	38%	3
Anti-corruption	GAC	M(2)	0%	0

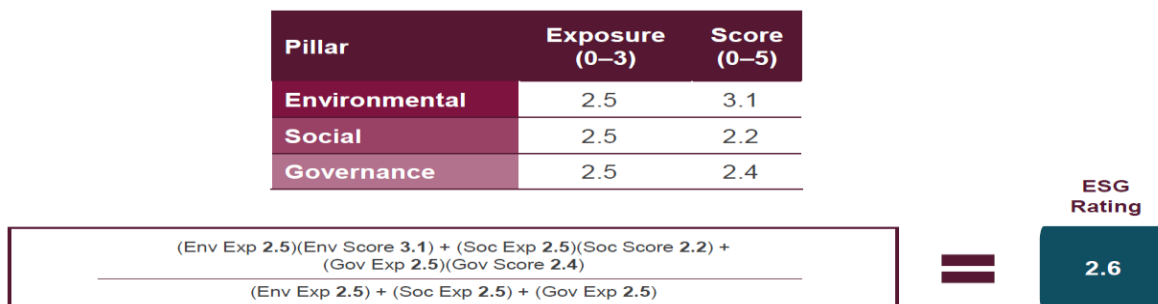
Source: FTSE Russell

Pillar score is an exposure-weighted average of applicable theme scores. Therefore, a High Exposure score (3) will have a x3 the weight of a Theme score that is Low Exposure (x1) for the relevant issue. For example,



Source: FTSE Russell

Finally, the overall ESG rating is calculated as an Exposure-weighted average of the three Pillar scores. Example below:

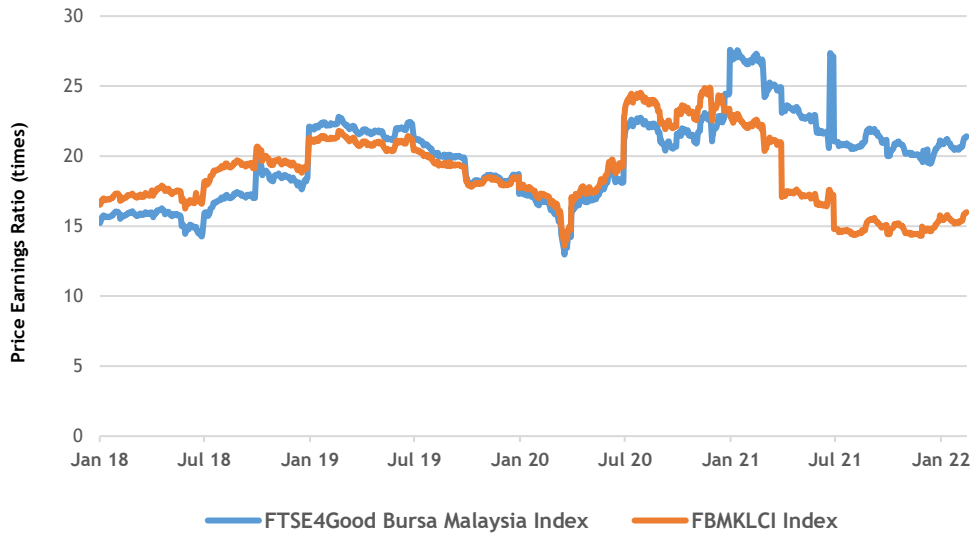


Source: FTSE Russell

Performance comparison

From the chart below, the FTSE4GOOD Bursa Malaysia Index constituents commanded better valuation over FBMKLCI Index constituents. For the full list of the PLCs listed under FTSE4Good Bursa Malaysia Index and their ratings, please [click here](#).

Figure 4: PER chart for FTSE4Good Bursa Malaysia Index and FBMKLCI Index



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