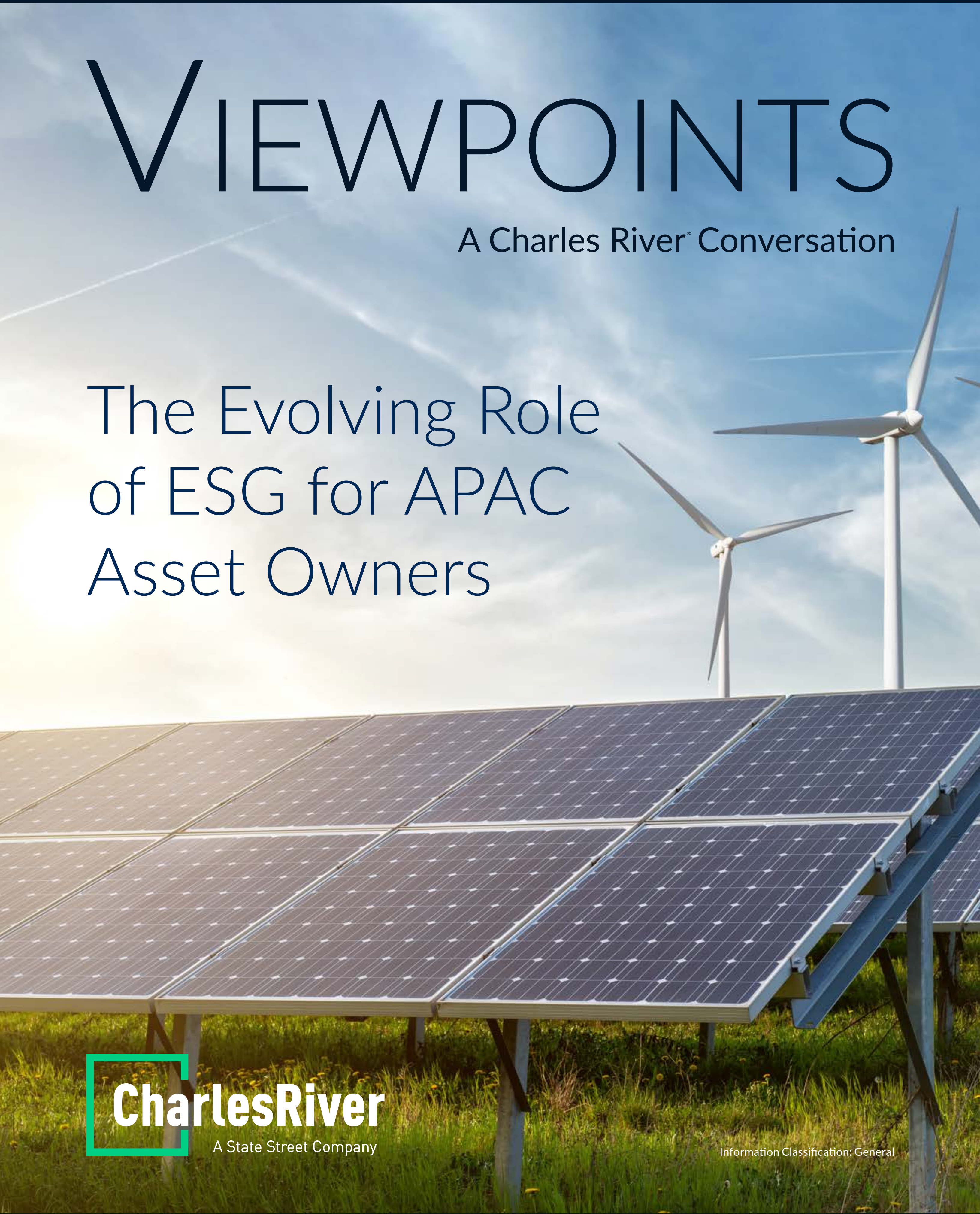

VIEWPOINTS

A Charles River® Conversation

The Evolving Role of ESG for APAC Asset Owners

CharlesRiver
A State Street Company

Information Classification: General

Managing Environmental, Social and Governance (ESG) goals and commitments is increasingly top of mind for pensions, insurance companies and sovereign wealth funds in APAC.

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Collectively, APAC asset owners hold more AUM than any other region globally, and these organizations have significant influence to effect change. Much remains to be done, as analysis conducted by S&P Global shows that no industry sector in APAC currently aligns with the Paris Agreement targets limiting temperature rise. Understanding differences between developed and developing nations in the region is key to understanding ESG priorities.

Nidhi Singh, Chief Product Officer at Charles River convened a discussion with Konstantina Founta, State Street's Head of Risk Analytics in APAC and Peter Sherriff, Charles River's APAC Director of Product Strategy to discuss the emerging ESG landscape and how State Street and Charles River are helping forward looking asset owners reach their prescribed goals and targets.

NIDHI: After COP26, how are emerging regulations on climate change impacting APAC asset owners and how are they responding to demands for decarbonizing companies they own or invest in?

PETER

Climate risk is highly topical as we're moving towards net zero and it's certainly impacting asset owner portfolios, but there are nuances. In conversations with a number of clients, ESG is a key topic, specifically because of the regulatory frameworks coming into existence across the region, whether it's Hong Kong's Climate Action Plan 2050, the Monetary Authority of Singapore's Green Finance Action Plan, or APRA here in Australia.

Asset owners understand the need for sustainable investments as part of their social responsibility commitments, and determine what that transition means from a portfolio construction perspective. It would be easy to simply exclude polluting stocks in industries like fossil fuels or mining that have a significant carbon footprint. But many aren't convinced that's the right approach for them. Shedding those assets creates opportunities for other players to invest and reduces transparency and visibility into the climate impacts of these industries.

An increasing number of asset owners are looking to effect meaningful change by partnering with like-minded organizations to gain board representation and drive more activism. Rather than making it a stock selection decision they're looking for constructive ways to facilitate the transition to net zero within the mining and energy industries.

We're also seeing this approach become more commonplace when addressing private investments. Asset owners and insurance companies are increasingly taking active partnerships that have alignment with and visibility into their progress towards sustainability and development goals. For example in Australia one of the insurance companies has a well-developed program, targeting five of the UN's 17 sustainable development goals to drive collaborative projects and investments focused on things like poverty reduction and access to clean water.

It will be interesting to see how the global asset owner community and developed nations respond with investments in new technologies and economic capabilities.

KONSTANTINA

A key takeaway from COP26 was the message from developing nations to their developed nation counterparts they need to make substantial investments that help finance the transition to green economies. Without those funds, the transition will be slow and painful, and developing nations won't reach their goals in the proposed timeframe.

It will be interesting to see how the global asset owner community and developed nations respond with investments in new technologies and economic capabilities to help make those polluting and extractive industries more environmentally friendly. There's a tacit understanding that by helping to transition the economy into a cleaner state, carbon emissions may get worse before they get better, because they need to invest in projects that actually make an impact, which means buying brown companies and transitioning them to green.

Palm oil, for example, is one of the biggest contributors to deforestation and air pollution across APAC. The amount of sustainable palm oil that is produced is relatively small, despite commitments from several global corporations to use sustainably produced oil. It's more expensive than conventionally produced oil so investment in sustainable production should narrow that price disparity. Money flowing into these economies to help improve sustainability will give us the knock-on effect on the environmental side.

In countries like Malaysia and Indonesia that don't have the most environmentally friendly economies, asset owners working with both listed and unlisted companies in their portfolio to make that transition is ultimately going to create better outcomes than simply divesting those assets.

NIDHI: How are asset owners striking a balance between social and environmental priorities in their respective countries?

KONSTANTINA

In APAC, there is a different prioritization of the environmental and social factor for both developed and developing countries. While transitioning to sustainable palm oil production and eliminating deforestation sounds amazing, it means thousands of people working in conventional palm oil production would need to be retrained. The same with mining and other brown industries. While "E" is the main focus for western countries, in APAC we have seen examples where asset owners recalculate ESG scores using their own methodologies, to weight the "S" more heavily than the "E" in their assessments.

Arguably, the most important role of sovereign wealth funds is balancing environmentally sustainable investment and their fiduciary duty without adversely impacting their citizens' retirement.

Fundamentally, the job of the Singaporean sovereign entities is to contribute to the income of Singapore as a nation and government projects that improve the life of its citizens, such as funding affordable housing projects. Ultimately, Singapore will have to find a way to ensure sustainability within their social responsibility supporting housing and growth.

PETER

As another example, Australian Superannuation funds have trillions in assets under ownership. Quite often, they have aligned interests across both environmental and social factors. So when they act on things like proxy voting, we tend to see them as one big pension fund instead of many smaller entities.

The proxy piece has come under scrutiny from regulators recently. There are only a few organizations that analyze governance and provide proxy voting recommendations on the portfolio companies held by the superannuation funds. It will be interesting to see how the regulatory framework around these organizations pans out over the next year. Regulators want to ensure each superannuation company is acting in the best interests of its own members, which is their primary obligation.

In Australia, regulators are pushing the superannuation companies to develop more robust retirement products. Whether it's how they look at generating returns or the Your Future, Your Super regulations, it's putting pressure on funds to perform to a certain level or merge.

This is driving new focus on product options, ensuring a particular retirement product meets the expected outcomes for their members at retirement. I think a progression will occur from environmentally sustainable investments to ensuring that retirement outcomes aren't adversely impacted.

Governments are getting involved in pushing new governance frameworks and placing the onus on individual companies to do more in terms of ESG monitoring.

NIDHI: Asset owners integrating the UN's sustainable development goals into their portfolio management practice requires those organizations to have the right governance, oversight, and transparency into those activities. How does governance intersect with the environmental and social aspects?

PETER

Governance is the wrapper over the environmental and social factors. The way an organization is managed and how their oversight process is implemented, today largely focuses on the climate action and social credentials of the organization.

Organizations are backing initiatives like the Climate Action 100 Benchmark that enables observers to track and monitor the progress of companies' transition to net zero. Governance is the framework by which asset owners are able to ensure that what they're seeing in terms of environmental and social actions from companies in their portfolio is honest and transparent.

Inclusion and diversity is an aspect where maturity level and progress on issues like female representation and greater diversity on corporate boards vary significantly by country. Asset owners are taking it seriously and getting their own house in order, with those further along that journey starting to be more active by advocating for things like increased female board representation.

Governments are getting more involved in pushing new governance frameworks and placing the onus on individual companies to do more in terms of ESG monitoring, whether it's New Zealand, where the government is mandating a level of reporting on carbon emissions or its Japan revising its corporate governance code to require corporations to report on diversity, sustainability and climate risk. Asset owners are getting the benefit of these regulatory mandates from a corporate governance perspective.

KONSTANTINA

It’s a matter of priorities. For many nations, diversity is a “Day Two” problem because they are dealing with more pressing issues. From a governance perspective, large asset owners have the power to make changes in their due diligence processes. It’s noteworthy that governance is the first TCFD pillar, ahead of strategy and risk management disclosure.

I used to ask pension fund clients how they incorporate ESG into their due diligence, not only for choosing external investment managers but also infrastructure and real estate investments. It was largely a box ticking exercise. But over the last few years, I’ve seen a major change, in that there is continuous due diligence around governance and also green washing.

With regulators asking for clear proof of targets, measuring progress towards those targets and disclosing that information on a timely basis has an impact on the governance of the asset owners themselves. They are scrutinizing how to implement ESG within their respective organizations, as well as the governance of their investment managers and the companies in their portfolio to influence voting and outcomes.

NIDHI: As a global organization we’re closely following regulatory developments across the globe and producing fit-for-purpose reporting solutions. How are we helping asset owners attain their ESG vision?

KONSTANTINA

ESG has become part of the investment life cycle across the front, middle and back office. We provide our clients with portfolio, risk and ESG analytics that help them gain a holistic view of their portfolio and change their investment approach to incorporate ESG. Reporting capabilities are especially key for asset owners with complex investment structures across their internal and external asset managers. Collecting, aggregating and standardizing this data across different investments is complicated.

From a regulatory standpoint, APAC tends to follow EMEA and the US. For example, Hong Kong is introducing regulations and taxonomy very similar to the European model. While we scale knowledge globally, we’re flexible enough to accommodate specific regional requirements, whether these are regulatory or related to internal governance.

PETER

Fundamentally, it comes down to the dual pillars of data management and decision support. ESG involves sourcing, ingesting, and standardizing thousands of data points from multiple providers. Extracting meaningful information from that data is a complex task. The harder or slower it is for stakeholders to access data, the less likely it is to be incorporated into their decision making or reporting.

From a decision support perspective, understanding how ESG factors will be impacted by different economic or factor-based scenarios, and understanding how those market changes will impact fund performance and inform portfolio construction is critical. It helps asset owners understand the carbon footprint of their portfolio, key social or governance metrics and ensuring their portfolios are moving in the right direction to effect meaningful change.

Asset owners are able to take advantage of State Street's scale and expertise managing that data, making it easy to ingest and incorporate across the full life cycle of the investment, whether it's the front office using Charles River for decision support or truView® for risk management and statutory reporting. It's a massive uplift in capability for most of the asset owners we work with.

Learn more about Charles River's ESG Capabilities at crd.com/esg

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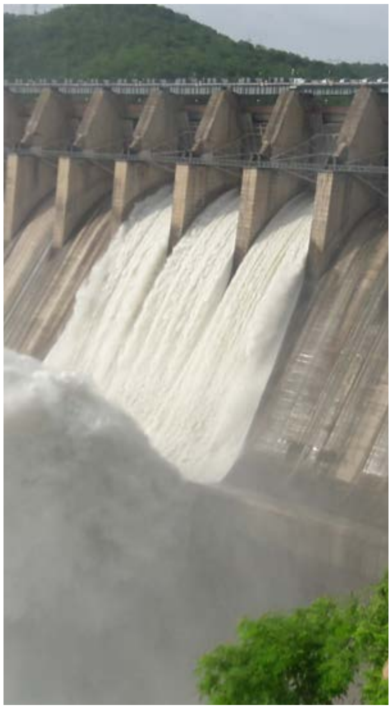

Charles River Development, A State Street Company

Investment, wealth and alternative managers, asset owners and insurers in 30 countries rely on Charles River IMS to manage USD $36 Trillion in assets. Together with State Street's middle and back office services, Charles River's cloud-deployed front office technology forms the foundation of State Street Alpha℠. Charles River helps automate and simplify the investment process across asset classes, from portfolio management and risk analytics through trading and post-trade settlement, with integrated compliance and managed data throughout. Charles River's partner ecosystem enables clients to access the data, analytics, application and liquidity providers that support their product and asset class mix. We serve clients globally with more than 1,200 employees in 11 regional offices.

(Statistics as of Q4 2021)

Learn more about Charles River's ESG Capabilities at crd.com/esg