

How Singapore's
asset managers
should respond as
ESG transforms
capital markets.



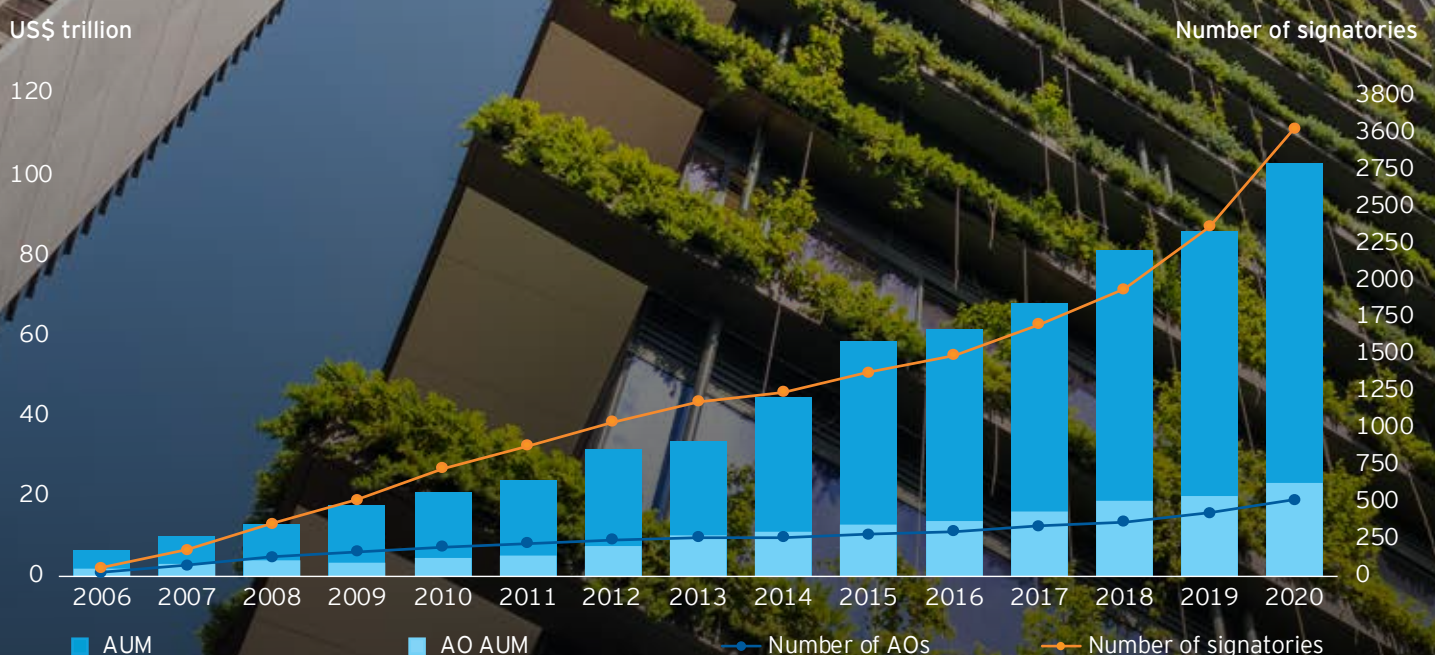
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The better the world works.



Building a better
working world

Global environmental, social and governance (ESG) trends at a glance

The number of signatories for the Principles for Responsible Investment (PRI), supported by the United Nations (UN), has grown substantially since its establishment in 2006. As of December 2020, there were 3,611 signatories with assets under management (AUM) exceeding US\$103.4trillion, of which 37 signatories were from Singapore.



Source: Principles of Responsible Investment, unpri website, <https://www.unpri.org/>, accessed 1 December 2020.

*AO: Asset Owner

ESG regulation and taxonomy

Regulations for ESG information disclosure and ESG investment are intertwined and can mutually enhance each other. Recognition of the positive impact of ESG activities on business operations and value, as well as the increasing demand by investors for more information on how corporates manage their ESG risks, has resulted in a rapidly changing global regulatory landscape in ESG matters. Meanwhile, it is encouraging to witness that integrating ESG factors in asset management and risk management processes are gaining momentum.

Economies					
ESG information disclosure	As of 2020, Guidelines for Environmental, Social and Governance Information Disclosure of Listed Companies in Shanghai Stock Exchange is currently in its consultation phase.	In 2019, the Hong Kong Stock Exchange (HKEX) released a conclusion on its consultation paper, which further tightened the rules for ESG information for listed entities.	In 2016, the Singapore Exchange (SGX) published the Sustainability Reporting Guide, which mandates annual sustainability reporting by all listed companies on a comply-or-explain basis.	In 2017, the London Stock Exchange (LSE) issued the ESG reporting guide to encourage listed companies to publish ESG reports. In 2019, the UK Government published the Green Finance Strategy report, which highlighted the expectations required of large asset owners and all listed companies to disclose information in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations by 2022.	In April 2020, the European Council published the Taxonomy: Final report of the Technical Expert Group on Sustainable Finance, which served as an EU-wide classification system for environmentally sustainable economic activities. Under the proposed Taxonomy regulation, institutional investors and asset managers marketing investment products as “environmentally sustainable” would need to explain if and how they have used the EU Taxonomy criteria.
ESG investment	In 2018, partnering with the City of London, Green Finance Committee (GFC) launched the Green Investment Principles (GIP) for the Belt and Road Initiative (BRI). In the same year, the Insurance Asset Management Association of China (IAMAC) issued the Green Investment initiative for China insurance asset management industry. In 2019, following the Green Investment Guidelines launched in 2018, the Asset Management Association of China (AMAC) issued a notice for fund managers to submit a self-assessment evaluation report for the Green Investment Guidelines.	In 2019, The Securities and Futures Commission (SFC) of Hong Kong issued a circular to the management companies of the SFC-authorized unit trusts and mutual funds – green or ESG Funds. In May 2020, authorities, including the Hong Kong Monetary Authority (HKMA) and HKEX jointly set up the Green and Sustainable Finance Cross-Agency Steering Group to accelerate the growth of green and sustainable finance. In July 2020, amendments to the HKEX’s ESG Reporting Guide and related listed rules came into effect. In October 2020, the SFC launched a consultation on proposed requirements for fund managers to address the climate-related risks of investing in funds.	In 2019, the Monetary Authority of Singapore (MAS) announced US\$2billion for the Green Investment Program (GIP). This will place funds with asset managers who are committed to driving regional green efforts beyond Singapore and in managing environmental risks. In December 2020, MAS finalized the guidelines on environmental risk management for asset managers, banks and insurers. The guidelines are intended to set out sound practices in relation to these financial institutions’ governance, risk management and disclosure of environmental risk. The guidelines were co-created with financial institutions and industry associations from the banking, insurance and asset management sectors. The guidelines also serve as a call to action for financial institutions to support the transition to an environmentally sustainable economy. This is possible by enhancing the integration of environmental risk considerations in the financial institutions’ financing and investment decisions, and promoting new opportunities for green financing.	In 2020, the UK Financial Reporting Council revised the UK Stewardship Code to reflect and integrate ESG elements to guide responsible allocation, management and oversight of investment capital.	In March 2018, the European Commission released an action plan for financing sustainable growth to reorient capital flows to ESG investments and mainstream sustainability into risk management by clarifying institutional investors and asset managers’ duties, regarding sustainability.

Responses of asset managers to market and regulatory impacts of climate change and sustainability issues, especially during COVID-19

Wealth and asset managers are experiencing a time of exponential change.

In today's environment, while the world is responding to the pandemic, asset managers should rethink what they should do and how they should conduct their businesses. This is because we can no longer ignore the physical, market and regulatory impacts of climate change and sustainability issues.

There is a global trend for organizations to respond to the risks and opportunities related to these impacts, as well as an increasing expectation regarding the adoption of ESG- incorporated practices, from both regulated and non-regulated parties.

In order to realign and prioritize long-term value creation and gain competitive advantages in the coming years, an increasing number of asset managers are considering or have already incorporated ESG research and portfolio management into their investment process. They are also implementing ESG factors and enhancing climate risk methods within their investment due diligence and risk management processes.

By integrating ESG considerations, wealth and asset managers can be better protected against risks and also better price the assets they are investing in.



Opportunities and challenges

Investors are increasingly asking whether asset managers have considered the ESG risks and whether such risks have been adequately addressed. They are assessing not only the financial performance, but also the nonfinancial factors of the underlying investments.

According to the *2020 EY Climate Change and Sustainability Services (CCaSS) Institutional Investor survey*, 72% of investors surveyed said that they had conducted a structured, methodical evaluation of nonfinancial disclosures – a significant jump from the 32% in 2018.

Other than the ESG disclosures, investors are looking for investments that incorporate impact investing or ESG-related factors. According to the *2019 Annual Impact Investor Survey by Global Impact Investing Network (GIIN)**, the overall impact investing AUM was estimated at US\$502b, as of the end of 2018. Asset managers accounted for approximately 50% of the estimated AUM, reflecting the fact that investor preferences for ESG factors were becoming mainstream. Asset managers are responding to these investors' needs by offering ESG integrated funds with impact investing strategies, or by focusing on specific social or environmental theme or outcomes, such as decarbonization, high-impact disease research and greenhouse gas emissions.

*Source: Annual Impact Investor Survey," thegiin website, www.thegiin.org/assets, accessed 1 June 2019.



In addressing investors' needs and concerns, asset managers are facing a number of challenges, such as limited availability of data; lack of expertise in comprehending ESG issues by understanding indicators to track different strategies; difficulty in identifying if ESG factors are integrated to the core; and the cultural challenge of viewing ESG as a compliance exercise rather than a value creator.

From the regulatory perspective, regulators are continuing to expedite the implementation of ESG disclosure and benchmarking regulations during the pandemic. Also, they are being more focused on defining a consistent approach on integrating ESG-related investments into the overall investment strategy of the asset management firms, with a robust underpinning of the risk management framework to support such investments.

MAS released Guidelines on Environmental Risk Management in December 2020 for asset managers, banks and insurers in order to build resilience of the financial sector to environmental-related events, and strengthen the financial sector's role in the transition to an environmentally sustainable economy. The MAS Guidelines outline expectations for financial institutions (FIs) in the following areas:

- ▶ **Governance and strategy** across an organization through the board's oversight, appropriate management structure, financial and human resources and internal controls.

- ▶ **Investment management** process for funds through an enterprise risk management framework that provides for the identification and assessment of relevant and material environmental risks and factoring the material risks into investment management process.
- ▶ **Risk management** procedures by adopting appropriate steps, tools and metrics to identify, assess (and quantify), manage and monitor the relevant and material environmental risks for its investments (portfolio and customer levels where relevant).
- ▶ **Disclosure**, with respect to the board's and management's roles and responsibilities, investment management process, risk management approach, and clear metrics and targets, in line with the international reporting frameworks, such as the TCFD.

Where environmental risk is material, FIs are expected to develop capabilities in scenario analysis in evaluating the resilience of investment strategies to environmental risks and impacts to risk portfolios and business strategies. The analysis should include short-and long-term environmental scenarios, with an assessment of physical and transition risks across a range of climate-related scenarios as appropriate.

Key priorities for asset managers and other industry players in Singapore

Asset management firms should look at the inclusion of ESG factors, and their alignment with key regulatory expectations as an immediate critical priority. This should be done in order to understand key areas for development and to focus on implementing a strategic plan in the long term, based on the priorities identified.



Understand alignment with regulatory expectations:

- ▶ Strengthen ESG governance with board oversight
- ▶ Assess and manage ESG risks, particularly environmental risks to meet MAS Guidelines
- ▶ Undertake ESG disclosure and reporting



Strengthen risk management framework and develop key initiatives:

- ▶ Develop strategic ESG investment principles and approaches
- ▶ Perform ESG screening and due diligence on potential targets
- ▶ Monitor and manage a portfolio's ESG performance
- ▶ Actively pursue ESG opportunities in the market



Implement strategic initiatives to fully integrate ESG factors into the firm's value proposition and increase competitive advantage:

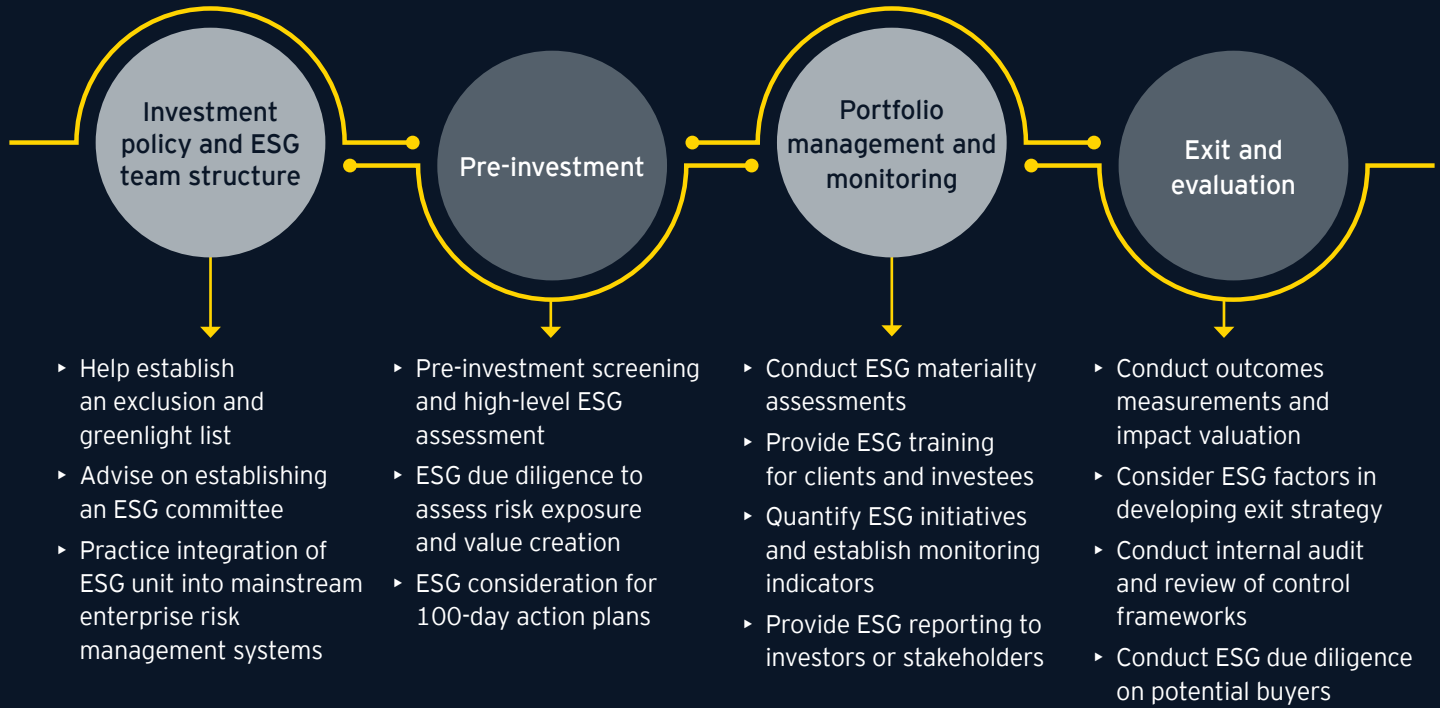
- ▶ Environmental stress testing
- ▶ ESG performance analysis
- ▶ Stewardship and engagement
- ▶ ESG impact measurement of investments

EY services for asset managers



ESG investment strategy advisory

EY teams aims to provide clients with a broad range of ESG investment advisory services, which are designed to help clients address emerging ESG opportunities, manage risks, reduce compliance costs, and improve operational and performance effectiveness.



ESG risk assessment tool

The EY ESG Risk Assessment tool intends to help investors understand inherent ESG risks of its existing and potential portfolio. The results derived could be fed into portfolio evaluation to further support an ESG-factored investment decision process.



ESG risk management advisory

EY teams assist clients in the incorporation of ESG factors and in improving or developing ESG risk management systems with the help of integrated and leading consulting metrics. We have provided ESG risk advisory services for clients operating in diversified financial fields, such as banks, secondary market investors, private equity (PE) and insurance funds.

The EY ESG risk management system integrates leading nonfinancial risk management tool boxes in the market, which include:

- ▶ Climate scenario analysis
- ▶ Environmental stress testing
- ▶ Nonfinancial risk profile dashboard

With the development of artificial intelligence (AI) and big data, we recommend that investors actively look at embedding ESG risk management modules into core systems to achieve dynamic and proactive ESG risk management.

ESG reporting assurance and advisory

EY teams have provided ESG reporting and advisory services for over 100 leading local organizations, including more than 50% of the top constituents of the iEdge SG ESG Leaders Index. We assist financial institutions in developing their ESG strategies or responsible investment approaches and in complying with regulatory requirements, such as the newly introduced MAS Environmental Risk Management Guidelines for asset managers, banks and insurers. It is encouraging to see that the importance of nonfinancial performance for the asset management sector is increasing in terms of regulatory requirements and investment decision-making process of investors.

Selected credentials

ESG Integration Advisory Service for a PE firm

A PE firm, focused on funds and direct co-investments in Asia, sought the EY services to integrate ESG considerations into its investment life cycle. EY teams provided a broad advisory package for the firm, beginning with the development of its responsible investing approach, and culminating in an ESG policy and various tools to support the policy implementation. These tools included an interactive risk assessment tool customized to identify and rate its portfolio ESG risk exposures, due diligence and monitoring templates to track its investees' ESG performance and an ESG reporting structure for reporting to its principal investor.

EY services include:

- ▶ Responsible investment approach advisory
- ▶ ESG or responsible investment policy development
- ▶ ESG inherent risk assessment tool development
- ▶ ESG due diligence and monitoring template development
- ▶ ESG reporting for investors



ESG impact and outcome measurement for a large-scale Asia-based investment firm

To help the firm understand, measure and communicate the positive contributions of its foundation, EY conducted an impact study of the foundation's philanthropic programs. Through a study of the philanthropic landscape and extensive stakeholder consultation, EY developed a framework, identifying its impact areas and defined metrics to measure real impact, and tailored a roadmap to support the client to continue monitoring those metrics into the future.

- ▶ Impact and outcomes measurement

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ESG due diligence for one of the world's largest global PE firm

EY teams help clients conduct ESG due diligence prior to investments or acquisitions. To date, EY teams has supported this global PE fund on several of its investments in Asia, spanning the private health care, renewable energy and engineering sectors. Our due diligence services are built on, first, determining material ESG matters for the target with reference to established standards like the Sustainability Accounting Standards Board. Thereafter, the team conducts in-depth documentation reviews and stakeholder interviews to assess the target's ESG management and performance, followed by a recommendation of key improvement plans for implementation support.

EY services include:

- ▶ ESG due diligence
- ▶ Recommended 100-day action plans

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