BY **TAN ZHAI YUN**

GETTING TO KNOW THE NEW ESG FUNDS

Since the Covid-19 pandemic broke out, ESG-themed investing has become the flavour of the year.

According to Morningstar, assets under management (AUM) for ESG (environment, social and governance) funds rose 29% globally in 2020, while Lipper data showed that estimated net flows into ESG funds in Asia set a record high (since at least 2006) from the third quarter of 2020.

This interest from investors was also captured by asset managers, who introduced new funds aligned to this trend.

In Malaysia, at least six ESG-themed funds were launched in the first quarter of 2021. Last year, two such funds were added into the mix.

These eight funds join the ranks of nine funds in Malaysia that either state their ESG and sustainability focus in the fund name or are qualified as a Sustainable and Responsible Investment (SRI) fund by the Securities Commission Malaysia (SC).

Yet, despite the popularity of ESG-themed funds in recent times, the development of ESG investments is still considered nascent in Malaysia, say industry players whom *Wealth* spoke to, citing challenges such as a limited investment universe and lack of quality ESG reporting.

The limitations to growth are reflected in the types of ESG-themed funds available in Malaysia. Of the 17 funds, all but two have either a global or regional focus. The Singular Value Fund invests in Malaysian equities, whereas the BIMB-Arabesque Malaysia Shariah-ESG equity MYR still invests up to 30% of its net asset value in foreign stocks.

Najmuddin Mohd Lutfi, CEO of BIMB Investment Management Bhd, says: "From our experience in launching the fund, only about 80 of the 1,000 stocks available on Bursa Malaysia comply with our ESG requirements, as assessed by Arabesque's S-ray screening tool. We diversified into foreign stocks to grab the opportunities available in both local and global markets."

BIMB was one of the early fund houses to launch an ESG-themed fund in Malaysia. Its ESG funds are managed using technology from the UK-based Arabesque Asset Management, which collects more than 250 metrics from reports and news articles to generate an ESG scorecard for companies.

Echoing Najmuddin's view, Ahmad Najib Nazlan, CEO of Maybank Asset Management Sdn Bhd, says: "The investment universe [locally] is relatively limited compared to the global scheme of things. Therefore, to deliver the most value to our investors, it's better to construct a portfolio that consists of global securities for diversification to generate higher potential returns and manage downside risks."

Not easy for fund houses

Why is there a limited investment universe? A major reason is the lack of reliable ESG data from local companies, which David Ng, deputy managing director and chief investment officer of Affin Hwang Asset Management (AHAM), says is "the biggest challenge" the company is facing.

"There has been a dearth of publicly available ESG information locally, along with a lack of corporate commitment to long-term ESG targets. Some developments have been made, but we still have our work cut out for us to bring ESG to the forefront of business and investment management," Ng says.

The interviewees agree that reporting quality is not even across the board, resulting in data gaps.

"This presents challenges in terms of comparability when we undertake sustainability assessment of stocks for ESG-themed funds," says Lum Ming Jang, chief investment officer of Public Mutual Bhd.

This means fund houses have to invest extra resources to verify the accuracy of the information reported. Some rely on information from ESG rating agencies, while others such as BIMB use tech-enabled screening tools by third parties.

To be effective, however, the methodologies must be transparent.

"Each ESG data service provider usually uses an opaque proprietary scoring system. As a result, the ESG scores for a specific company can vary across different service providers, making it difficult for a fund manager to assess the scores," says Ahmad Najib.

ESG factors, which are generally non-financial data, are also not typically endorsed by third parties and the rules of disclosure vary, explains Ismitz Matthew De Alwis, CEO of Kenanga Investors Bhd.

If this is not monitored properly, it could result in cases of greenwashing. Given the rising number of ESG-themed funds, it is important for investors to take note of this point.

"Given the lack of a single ESG reporting standard, ESG offerings in the market may be driven by companies' ability to hype up ESG initiatives through effective marketing and advertising. That's why consistent and comparable data is crucial for investors to evaluate a company's ESG efforts. Bursa Malaysia's Sustainability Reporting Guide has a list of disclosure considerations, but not all companies appear to disclose the same set of indicators," says De Alwis.

He is referring to Bursa Malaysia's requirement for listed companies to include sustainability-related disclosures in their annual reports. These include statements of material ESG risks and opportunities and the governance structure in place to manage it.

Some listed companies have also committed to reporting according to international standards such as those set by the Task Force for Climate-related Disclosures (TCFD).

Despite the challenges, the interviewees acknowledge that it takes time for compa-

ESG-themed and SRI funds

FUND	YEAR LAUNCHED	RETURNS SINCE INCEPTION (%)	ONE-YEAR CHANGE (%)
Singular Asia Flexible Fund (SRI)	2007	322.6 (as at March 2021)	65.1
ICD Global Sustainable Fund (SRI)	2017	–	-9.09 (as at March 2021)
BIMB-Arabesque Malaysia Shariah-ESG Equity MYR	2017	23.6 (as at April 2021)	52.07
InterPac Social Enterprise and Responsibility Fund	2017	-18.74 (as at Jan 2021)	-1.19
Singular Value Fund	2018	411.9 (as at March 2021)	129.4
BIMB ESG Sukuk Fund MYR	2018	9.59 (as at March 2021)	2.85
BIMB-Arabesque Asia Pacific Shariah-ESG Equity MYR	2018	-1.92 (as at April 2021)	28.38
AmIslamic Global SRI	2018	–	16.8 (as a March 2021)
Public e-Islamic Sustainable Millennial	2019	–	–
Affin Hwang World Series-Global Sustainability USD	2020	7.8 (as at Feb 2021)	–
Maybank Global Sustainable Equity-I	2020	–	–
Public e-Carbon Efficient	2021	–	–
Maybank Global Sustainable Technology USD	2021	–	–
United-i Asia ESG Income MYR	2021	–	–
RHB i-Global Sustainable Disruptors Fund	2021	–	–
BIMB-Arabesque Global Shariah Sustainable Equity Fund	2021	–	–
Affin Hwang World Series – Global Climate Change Fund	2021	-	-

VARIOUS FUND FACT SHEETS

"Consistent and comparable data is crucial for investors to evaluate a company's ESG efforts." *> De Alwis*

How ESG is integrated into investment processes and products

Generally, there are two ways that fund houses can integrate ESG into their processes. One is by introducing themed funds in this area, and another is by integrating ESG factors into their investment analysis for all funds.

The companies that do the latter may not have funds that are explicitly ESG-themed. Doing so, however, could require more resources, as the fund house may need an in-house research team well versed in ESG issues. Those who do the former could rely on external investment advisers or incorporate feeder funds.

In Malaysia, several fund houses are building up their internal capacities to integrate ESG analysis across all funds.

For instance, Maybank's ESG-themed funds currently rely on the resources of its investment advisers, Schroders and Wellington Asset Management. "[But] we have laid out our own ESG development plan that includes product development, investment process, governance, monitoring and reporting," says Ahmad Najib Nazlan, CEO of Maybank Asset Management Sdn Bhd.

"The plan is to have a firm-wide ESG integration led by a dedicated ESG team that will carry out ESG research, perform ESG evaluation or attribution of portfolio, as well as other monitoring, administrative and reporting functions."

Affin Hwang Asset Management is already incorporating a range of ESG-related risks and opportunities in addition to financial analysis in its securities selection process, says deputy managing director and chief investment officer David Ng.

It is no mean feat, but Ng says the fund house has established an ESG investment team to spearhead the integration process.

"Our team of analysts and fund managers focuses on identifying and assessing material ESG issues that could have a financial impact on companies in our stock and bond portfolios. To do this, we use primarily third-party ESG research and ratings as our sources, besides the companies' disclosure and our own personal engagement with management. For companies without third-party coverage, we designed our in-house sector-specific questionnaires that can be used during corporate engagement sessions," says Ng.

Other fund houses have opted to do the integration in phases or focus on certain factors.

For instance, BIMB Investment Management Bhd currently avoids stocks with low ESG and United Nations Global Compact scores across its funds, but plans to expand more ESG analysis to its fund universe.

Meanwhile, Kenanga Investors Bhd plans to apply ESG standards to its responsible investing and ESG-integrated funds in phases. It will avoid sectors such as defence and companies with low ESG quality across all assets.

Public Mutual Bhd, whose ESG-themed funds are drawn from the S&P ESG Index, incorporates assessment of various governance aspects across its funds. The environmental and social factors are specifically considered for the ESG-themed funds.

Who's in and who's out?

A common method that fund houses use to build ESG strategies is screening, which employs filters to determine which companies or sectors should be included in a portfolio. Negative screening would exclude high greenhouse gas emitters, for instance, whereas positive screening targets only the lowest emitters.

Thematic funds focus on specific topics; integration explicitly includes ESG issues in the investment analysis process; and engagement involves discussion of ESG issues with companies.

A quick glance across the ESG-themed funds in Malaysia shows that the fund houses use a combination of these tools.

Some investors may question why certain companies that are in the news for alleged violations of labour rights or for causing environmental harm are included in ESG-themed funds.

The interviewees say they consider a wide range of factors when deciding whether a company should stay in the portfolio. They also emphasise that exclusion of companies may not be the best immediate solution.

Instead, engagement with investee companies or proxy voting are important, so that investors can influence companies to change their ways. Institutional investors, which are often majority shareholders, could find this more effective.

"Proxy voting provides us with the ability to have direct influence over key corporate governance decisions concerning our investee companies, such as director's remuneration and board independence. Company engagement allows continuous dialogue with the senior management of our investee companies," says Ng.

The fund house also regularly reviews the lower-rated ESG companies in their portfolio and actively follows up on recent controversies, he adds. "These issues are assessed in terms of their materiality and the initiatives being put in place by the corporation to address the issue."

After this assessment, the investment team will conduct a discussion on the resulting portfolio action.

Ng emphasises that the fund house does not want to cut off a company completely. "We want to be part of the solution, because cutting them off is not effective. We're not here to penalise anyone but simply want them to actively do better." E

"There has been a dearth of publicly available ESG information locally." > *Ng*

"It needs both top-down and bottom-up approaches to make ESG a norm in Malaysia." > *Ahmad Najib*

nies to adapt to these guidelines.

"We believe continued engagement and conversations with corporates can better align the type of ESG data points and depth of disclosure required by investors for their due diligence," says Ng.

"This is not too dissimilar to the conventional financial metric disclosures that companies have enhanced tremendously over the years, just by listening and adapting to the needs of the investor community."

A work in progress globally

The difficulty in reporting ESG issues is a problem recognised globally as well. Last September, five of the most significant sustainability standard-setting institutions, including the Global Reporting Initiative and CDP, announced that they would develop a comprehensive solution for corporate reporting.

"If you look at Europe, the policymakers have come up with an EU taxonomy (a classification system for sustainable activities), and a standard method for labelling ESG funds (ecolabel) and disclosure practices. Policymakers in Asia are recognising the need for these standards but they haven't reached that stage yet," says Deepak Khurana, director of sustainable finance and Lipper, Asia-Pacific, at Refinitiv.

New Zealand recently required all listed companies, managers of investment schemes, banks and insurers over a certain size to adopt the TCFD standards, which Deepak highlights as a good example.

Having a standardised reporting standard can mitigate greenwashing. In December 2019, Hong Kong's Securities and Futures Commission released a circular stating its intentions to enhance the disclosure standard of green or ESG funds.

This is a good step, Deepak explains, as companies need to provide enough evidence to back up their claim that a product is ESG-compliant.

But these should be done in tandem with all stakeholders, the interviewees emphasise.

"More industry-led initiatives can be developed with input from all stakeholders. Some examples are the roadmap of ESG integration in the investment process, consistent and inclusive ESG regulatory framework, encouragement to be signatories of global ESG standards and continuous innovation in ESG solutions for investors," says Chan Ai Mei, chief marketing and distribution officer of AHAM.

The good news is that a few factors are driving better ESG reporting among listed companies in Malaysia. One that is frequently mentioned is the push for ESG adoption by institutional investors such as the Employees Provident Fund (EPF) and regulators such as SC and Bursa Malaysia. The establishment of the FTSE4Good Bursa Malaysia Index in 2014 is also hailed as a good step. To be included in the index, companies need to meet an ESG inclusion criteria set by FTSE.

In addition, the Principles for Responsible Investment (PRI) has made it mandatory for its signatories to make public their reports on various indicators regarding climate change risks and opportunities in 2021. Ten Malaysian organisations — including Principal Asset Management, BIMB Investment Management and the EPF — are PRI signatories.

"It needs both top-down and bottom-up approaches to make ESG a norm in Malaysia. Companies must commit to running their business sustainably. Investors, both retail and institutional, need to have a stronger attitude on investing sustainably," says Ahmad Najib.

"Of course, the government and regulators' continuous support and incentives could expedite the whole process. Sustainable investments have grown tremendously in the US and European markets. If Malaysia adopts these standards fast, international investors would be flowing into our markets." E

What is driving the growth of ESG funds?

Millennials' rising interest in ESG investments, a focus on long-term investment trends and the outperformance of ESG investment products are seen to be contributing factors in the growing trend of ESG investing.

"This interest has been there for a while now but, during the pandemic, people saw the social and economic problems associated with it. Now, people are seeing merit in channelling their investments towards more sustainable areas," says Deepak Khurana, director of sustainable finance and Lipper, Asia-Pacific, at Refinitiv.

The outperformance of ESG investments also attracted investors. S&P Global Market Intelligence analysed 17 ESG-themed exchange-traded funds and unit trusts (with assets under management of more than US$250 million [RM1 billion]), and found that 14 outperformed the Standard & Poor's 500 index in the first seven months of 2020.

In addition, a Lipper study in April 2020 found that, of the 34,340 equity funds in the Lipper database, most conventional funds underperformed their respective technical indicators, while the majority of ESG funds outperformed theirs.

The authors of the study note, however, that the period of comparison is short and the universe of ESG funds still small compared with conventional funds. The exposure to tech stocks in ESG funds also explains its outperformance last year.

A quick check on the fund fact sheets of the ESG-themed funds in Malaysia shows that most have outperformed their benchmark indices since inception or in the past year. The new funds launched since last year do not have results over a significant period of time. E