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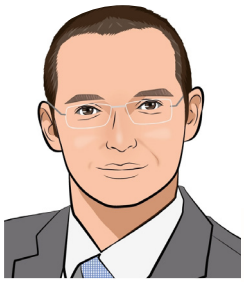
Asia's Private Wealth Market & Embracing the ESG Revolution

There are estimates that the managers of one-third of all professionally run assets globally, equivalent to well over USD35 trillion, now use ESG data and ratings to drive their investment decisions. And many of the other two-thirds today pay increasing attention to ESG criteria, especially those highly accountable investors such as sovereign wealth funds, major corporate pension funds, multi-billion asset family foundations and others. But, as the world's leading professional global investors increasingly embrace ESG, what progress is being achieved amongst investors in Asia, and specifically, are Asia's private clients yet jumping on the ESG express? The answer in brief is that Asia still lags rather behind, but there are more and more signs the region will play catch up. A fascinating discussion on this very topical subject took place on September 9, with a handpicked panel of experts deliberating the market's evolution to date and anticipating the next phases of growth and development ahead for the expanding world of ESG investing.

SPEAKERS

ARJAN DE BOER
Indosuez Wealth Management

MAXIME PERRIN
Lombard Odier Investment Managers



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Environmental, social and governance (ESG) criteria aim to help socially conscious investors to screen potential investments. Environmental criteria aim to define how a company performs from an environmental impact perspective, which has truly moved centre stage in recent years. Social criteria define how a company manages relationships with employees, suppliers, customers, and the communities in which it operates. And governance deals with a company's corporate culture, its leadership, executive and broader compensation, audits, internal controls, and shareholder rights.

In short, these ESG criteria are used to help investors identify companies with corporate values that they feel comfortable with and therefore that accordingly meet their investment requirements. Most professional investors today rely on third-party sourced ESG data and ratings, and there is no doubt that the collective influence of the providers of such data is set to grow and increasingly drive the decisions of fund managers, from sovereign wealth funds through the world's largest pension funds and all the way down to retail investors, including of course HNW and UHNW investors.

ESG is, therefore, an increasingly popular investment strategy worldwide. A growing body of research shows that ESG can reduce portfolio risk, generate competitive investment returns. Moreover, ESG investors accept this and also recognise that by supporting sustainable companies, they can make a positive difference whilst harvesting competitive financial returns. This recognition is spreading, and the growth of ESG in both popularity and coverage is almost certain to continue.

Expert Opinion

MARY LEUNG, Head, Advocacy, Asia Pacific, CFA Institute

"The role of finance is to allocate capital efficiently and that process is increasingly taking environmental, social and governance factors into account. ESG related expectations on issuers and institutional investors (in terms of strategic direction and disclosures) have accelerated in recent years. ESG is no longer a nice to have - it is an imperative for the industry to stay relevant and competitive."

ESG – moving centre stage

The discussion opened with an investment advocacy specialist expressing the view that the role of finance is to allocate capital efficiently and that process is increasingly taking environmental, social and governance factors into account. She observed that ESG-related expectations are rising for both issuers and investors - in terms of strategic direction and disclosures - and that ESG is no longer simply a nice 'bonus' element in investment considerations. In fact, it is today essentially imperative for the wealth management industry to incorporate into its daily activities in order to retain clients and to stay relevant and competitive.

Joining the virtual panel discussion from Geneva, an expert first reinforced how keenly his bank aims to identify which companies put ESG into action through their business practices, and also how the bank then delivers investment advice around those findings.

Expert Opinion

MAXIME PERRIN, Head of Sustainable Investment, Lombard Odier Investment Managers

"Regulatory environment is going to be a huge influence on how investors react, how asset managers structure products and what kind of disclosures they do. What is emerging with the new regulations is that the European Union has decided to approach the problem through a gradual tightening of rules. They are approaching this also through a gradual opening up of portfolios from a sustainability point of view and putting investors in front of their own claims and responsibilities, hence fighting greenwashing in one way or the other. If you look at the European framework in opening up transparency and tightening of rules, it is of a more 'naming and shaming 'attitude to regulations – at least so far. Asian markets will probably approach this with both the tightening of regulations and the temptation to name and shame for certain asset managers."

"ESG metrics are based on historical data, but we think that forward-looking metrics regarding company activities are much more important, given the huge challenge we have in terms of sustainability, which centres on the decarbonisation of the economy over the next 30 or so years," he explained. He said that this is particularly crucial in Asia given the breakneck speed of development and the incredible speed of future transition over the next few years, as highlighted recently by the Chinese government in 2020 and 2021 with their very ambitious decarbonisation targets.

Boosting accountability

He explained that as investors apply ESG metrics and analysis increasingly to their portfolios, companies are becoming more accountable for their behaviour through capital allocation, greater engagement, as well as through proxy voting.

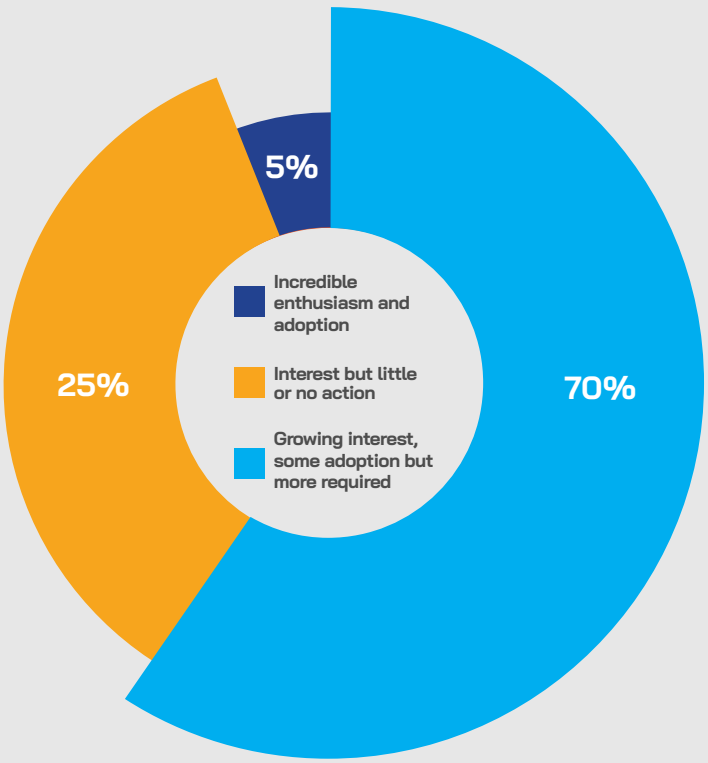
"We focus heavily on decarbonisation, which for some companies is quite a simple challenge, and for many companies in Asia and elsewhere is a huge and sometimes even existential challenge," he reported. And clearly, those companies that score highest in ESG metrics and ratings are more likely to be on the right path towards boosting and enforcing decarbonisation.

Across the investment world

Another expert added that ESG spans all asset classes and products and services and is most certainly here to stay. "For example, we now trade so-called green structured products that have very specific characteristics, and that we educate the RMs about, so they can clearly inform their clients. In short, we need continuous education from here onwards; we are all committed to that in our group and also working with external platforms, such as Hubbis."

The Hubbis Post-Event Survey

TO WHAT EXTENT ARE ASIA'S PRIVATE WEALTH INVESTORS ADOPTING ESG-DRIVEN INVESTING?



He also countered a view on the panel that ESG somewhere in the near future will become more of a hygiene factor.

Only at the start..."

I don't think this is a fad, in fact far from it," he said. "In fact, in terms of regulation, we're only at the very beginning, with some progress taking place in Europe, some but less in Asia and so forth. In short, we are seeing far greater interest everywhere, but there is much progress needed. Even the six of us on this panel today are, in reality, really only building our understanding and knowledge about this, and I will admit we're not there yet. This means we are nearer the start; the regulators are at the start, and governments are at the start that means our clients still have to go through this entire journey. In short, this is going to be a topic for many years to come before this is becoming a hygiene factor, in my view."

He added that as to expressing and marketing their ESG commitment, the larger financial services organisations and corporations find it

more affordable to have sustainability officers and ESG specialists, while for smaller operators and companies, it is less economically viable.

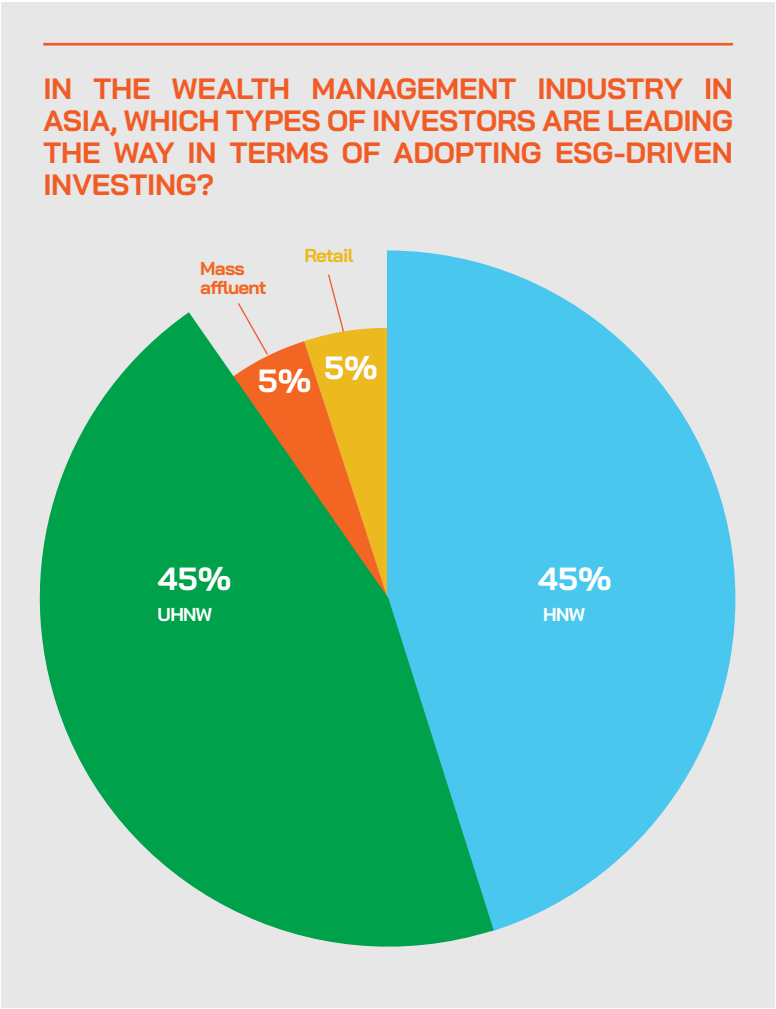
Education – core to the proposition

"We are naturally also very keen and enthusiastic about continuing education of the investment profession," another guest observed. "Indeed, we see many of the professionals enthusiastically now travelling on this journey and aspiring to be more knowledgeable in this very important segment. In brief, talent development and continuing professional education are key areas we spend a lot of time on."

"We are also part of a collective effort that will hopefully be helpful in later developing a set of standards that will help asset managers, particularly related to sustainability or the ESG attributes of their investment products," she explained. "But overriding all this, the more and more rapidly our members can upskill for these changes, the better; this is no fad; these issues are here to stay."

Far more than a fad

Addressing the question as to whether this is more fad than substance, an expert told delegates it is a bit of both at this time. "I can see there has been some scepticism about ESG, especially actually in Asia," he said. "However, since the pandemic hit, people have been taking this more seriously. Advances in the world of finance start at the institutional levels and then trickles down to private banking and ultimately into the retail space. We have actually been working on ESG for many years, and today report ESG scores in client portfolios; in fact, we have been doing that since 2015."



Substance and durability

Expanding on this subject of education and training, an expert explained that really the first hurdle in disseminating the vision of ESG and sustainability was getting the RMs on board. "Our experience has been that younger people are much easier to convince than older people, whether it's our relationship managers or whether it's our clients," he reported. "And today there is wider interest, wider media coverage and wider adoption. Whereas a few years ago, some people might not have known what ESG even stood for, today we are well past that, and certainly older clients are now becoming really interested."

He added that there is a growing body of evidence that securities with high ESG credentials achieve better returns. "We have models and data that show that has been the case since 2014, where we see that, predominantly from evidence in North America and Europe, returns are enhanced," he said. "Today, we maintain an active education series on this, first for our relationship managers, then directly and indirectly for clients."

And together with one of Europe's largest asset management groups, he reported they have joined forces to project their 'ESG

Academy'. "We work with bankers on ESG scorecards that they can go through portfolios with clients, and we are really boosting our internal education and training," he explained. "There is much more to do out here in Asia, we are still behind Europe, but we are catching up."

...and more education

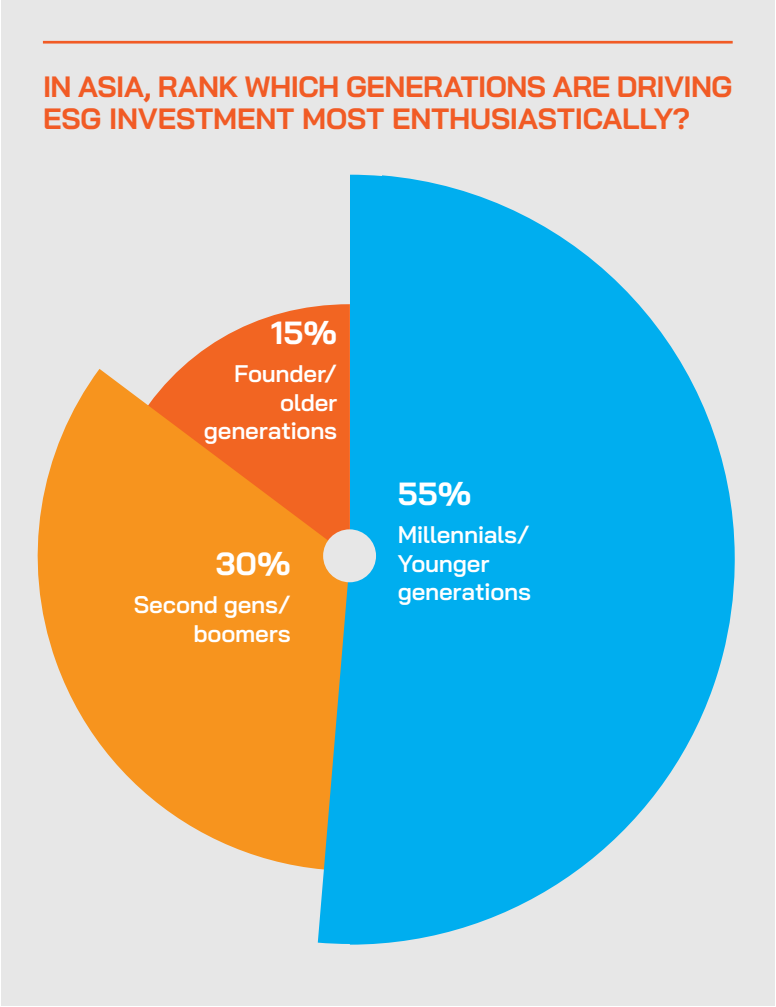
A fellow panellist also explained that their firm has significant ESG educational resources, but that knowledge must be tailored to specific needs, for example, whether the professional is a private banking RM or a portfolio manager or perhaps a sell-side analyst.

"In short, depending on your interests, and depending on where you are in the wealth management and ESG ecosystem, there are different avenues in which you can upskill," she observed. "The most outstanding individuals in this emerging world of ESG investing will be those who have a deep set of knowledge in one particular area, but also have a wide range of knowledge on a number of other things, and the ability to connect the dots."

A dynamic issue

Expanding on this theme, an expert explained that education and training is ongoing as ESG is not static; it is dynamic. "Moreover, there is new regulation coming in regularly," he reported, "so, for example, Singapore is about to set out new disclosure standards for ESG funds, and we will see more such moves elsewhere."

He noted that thus far, there are not yet any generally accepted ESG ratings or metrics, as there are widely accepted accounting practices. "The ESG scores that we use in our clients' statements are actually based on the ratings and assessments of eight different external parties," he reported. "I do agree this is rather complex, but we are all moving in the right direction, and there is increasing alignment."



Talent will drive growth, and vice versa

"But what is for sure is that there will be a whole class of new sustainability specialists coming on stream in the next decade or two, creating a whole new job category in itself. And just like after the global financial crisis, there were huge costs in terms of propping up your compliance departments; this is clearly another area where financial institutions and banks will have to invest."

He pointed, for example, to a major European asset management business, where they now employ more than 30 ESG specialists and work with some 14 external parties.

He explained that in their group, their strong ESG expertise and commitment spreads from advisory to asset management and capital markets, and it is therefore vitally important to educate their teams and ultimately clients. "For clients," he commented, "it is all about building resilient portfolios that can also comply with their personal aspirations. And at our firm, this is very much part of our culture, and we believe it will benefit us, our teams and our clients for many years to come, and even more visibly in the future."

Incorporating ESG into selection criteria

Another guest, representing an investment manager dedicated to Asia ETF and smart beta investment solutions, highlighted the value of ETFs and single-stock curation for expressing ESG but told delegates how they sidestep the use of active funds.

"When it comes to selecting ETFs, we prefer an ESG exposure," he explained. "And in building stock portfolios, we also apply ESG criteria, but the challenge, of course, is figuring out which vendors to use for the scoring, and what we should emphasise, the E or the S or the G."

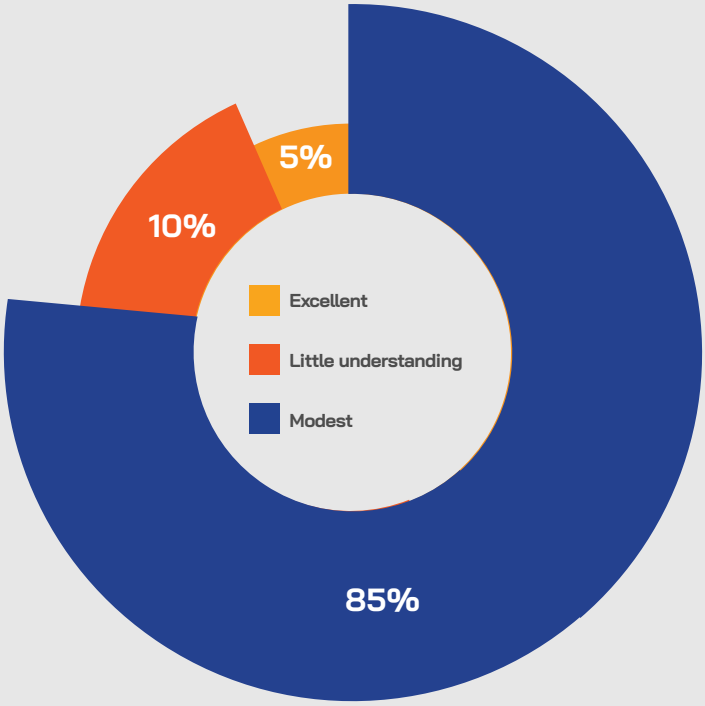
But he confirmed that the big picture story is the decision they made about a year and a half ago to fully integrate ESG into the investment process. "Today, we have no non-ESG portfolios at all," he reported. "We did not actually ask clients to sign up to that; we simply changed our portfolios to represent ESG as an investment thesis."

He explained that ESG makes its way into their ETF portfolios in one of two ways. Instead of buying MSCI World, they will buy an ESG version of that ETF. "It might be ESG light or ESG tilted, or it might be the much more aggressive version, where we actively remove the bottom 50% scores," he reported. "We do both, it depends on the situation."

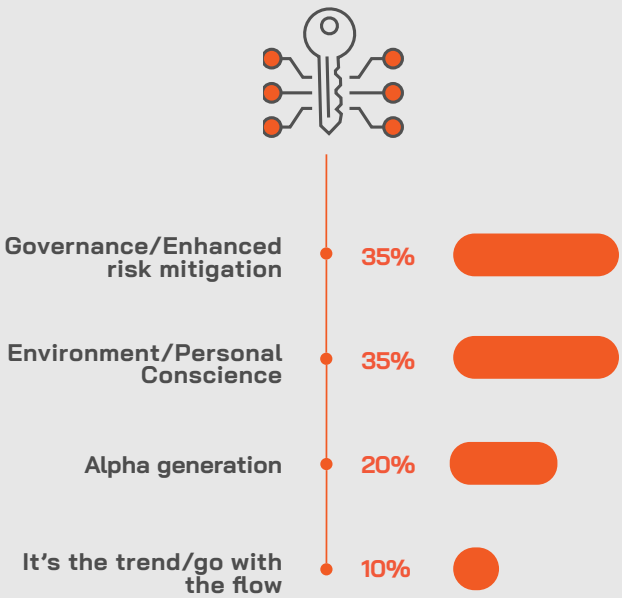
Expressing your inner 'ESG-ness'

The second approach is to actively select ETF formation. "I've never had a client who was really a passive investor," he said. "They might use passive instruments, but they are always very active with ETFs. That is possible because the ETF industry has become extremely granular in

HOW WOULD YOU CHARACTERISE THE GENERAL UNDERSTANDING OF ESG INVESTING PRINCIPLES AMONGST ASIA'S UHNW AND HNW WM CLIENTS?



AMONGST ASIA'S PRIVATE CLIENTS, RANK THE KEY DRIVERS FOR THE ADOPTION OF ESG INVESTING?



terms of the exposures it offers, you might have the standard type of index ETFs, but also for example a Junior Gold Miners ETF, a Clean Energy ETF, an EV ETF, Battery ETF, Blockchain ETF and so forth."

Accordingly, he said they would buy ETFs that invest only in specific sub-industries that are very ESG friendly, so the firm is overweight clean energy, a five- to 10-year trade they put on some time ago, in the view that clean energy will become the only energy. "I don't need an ESG ETF for that, I need a clean energy sector ETF," he stated.

From SRI to ESG – a continuum

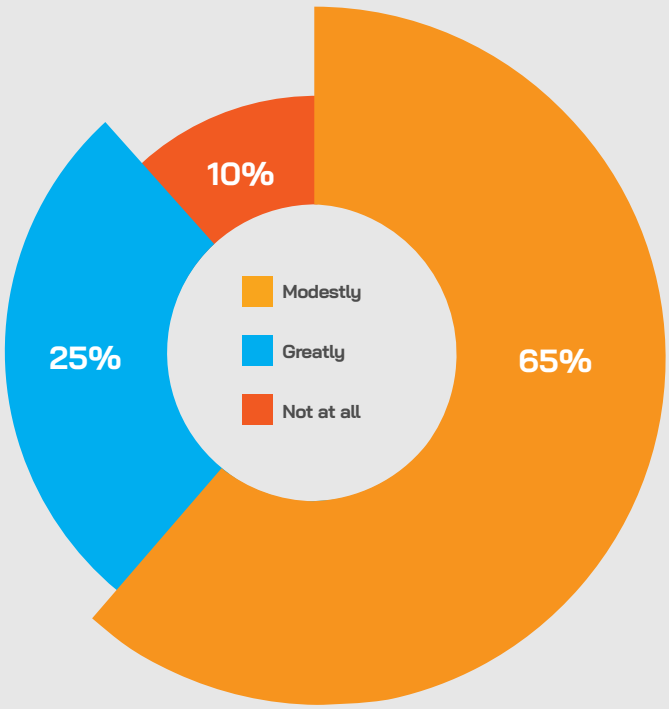
Another guest highlighted how when he joined as a portfolio manager at a leading healthcare pension fund in Holland back in 2005 there was a strong emphasis on SRI, driven actually by the labour unions.

"Today, in Asia we see that there is growing emphasis on ESG, and government support, and if clients are able to make the first steps and are able to show the good returns, that helps us prove the view that you're able to create at least a return equal to the conventional investments, and in certain circumstances even better. I see clearly in the younger generation a clear interest for ESG., and the older generation is asking for ESG solutions, where they try to steer away from the older and dirtier industries."

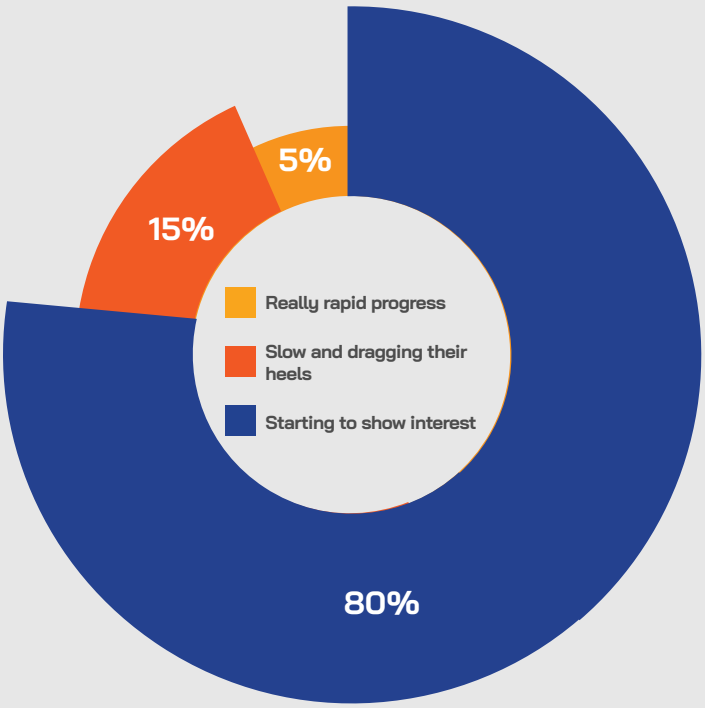
The growing drive to support society and communities

This same expert explained that their clients are in the wealth industry, hence are generally aware and knowledgeable about the key objectives and definitions around ESG, SRI and impact investing.

TO WHAT EXTENT DO YOU THINK ADOPTING ESG INVESTMENT CRITERIA WILL ENHANCE YOUR CLIENTS' PORTFOLIO PERFORMANCE?



TO WHAT EXTENT ARE COMPANIES IN ASIA EMBRACING AND ADOPTING ESG PRINCIPLES?



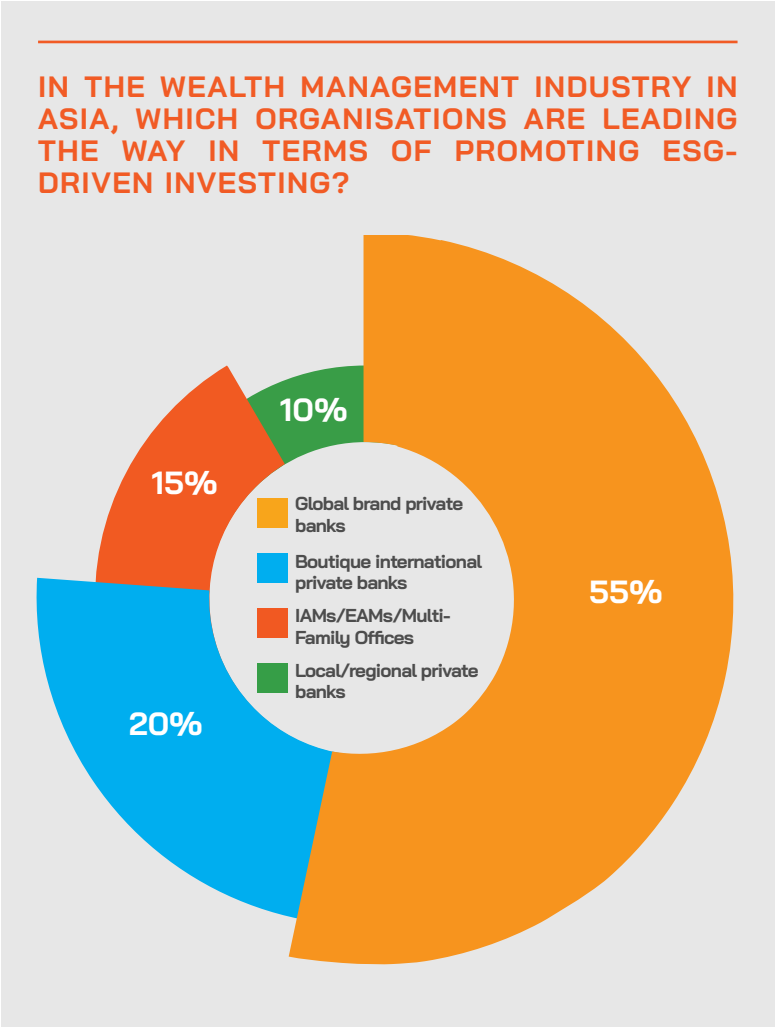
"They are usually targeting these investments to help boost returns, make their life better, but also make the lives of people in the countries where they live better," he commented. "A healthy society makes people happy. And finally, that's good for everyone."

Balancing the 'E', the 'S' and the 'G'

An expert explained that he finds that it is very easy to devolve the ESG conversation to the 'E' portion only, as that is the real newsmaker these days. "But the 'S' and 'G' are equally important and arguably, in our view, are longer term components of the ESG story," he said. "At some point, any company that's not environmentally aware will go out of business, it's going to happen because they're going to be put out of business by their governments. So, to some extent, everyone will gravitate to this space."

He commented that the 'S' and the 'G' have been around for longer in the professional investor psyche, perhaps especially the 'G', focusing attention on companies with more support for employees, those that have more diverse boards, that have better governance structures. "Whereas 'E' has come to prominence due to the realisation we need to fix the planet," he said, "the result of which is that those which manifest environmentally consciousness and action, will be those which make more money. So, we all focus heavily on 'E' today, but 'S' and 'G' also drive returns and are also equally important."

He added that coming from the financial industry, he personally focuses first on the 'S' for social. "I feel that an incredibly important part of investments is giving something back for the future generations," he said.



Clarity, transparency, integrity

A panellist explained that it is vital to strive towards better ESG data disclosure, which will bring greater clarity and transparency when presenting, identifying, comparing, or discussing products with ESG-related features. She told delegates how, in addition to investment education and training, her firm's commitment to ESG is inextricably bound up in the firm's passionate drive towards about investor protection and upholding market integrity.

"Within our investor universe, we believe the whole discussion around ESG and sustainability is critical to the future of the industry itself, especially when so many of our members are involved in the investment management profession, be they in the form of portfolio managers or analysts on the buy side or sell side," she reported. "Accordingly, our focus is really on how investors and asset managers are disclosing or have access to the right information that will allow them to make the right decisions, especially in this day and age when revenue, returns, reputation, risks are all interlinked.

Disclosures to reduce exposures

She reiterated that there is growing awareness of the issue of greenwashing and a growing focus amongst the regulators to curb excessive claims of ESG compliance. She cited a fairly recent circular from the Hong Kong SFC on what information is required and how funds should disclose if they want to be called ESG funds.

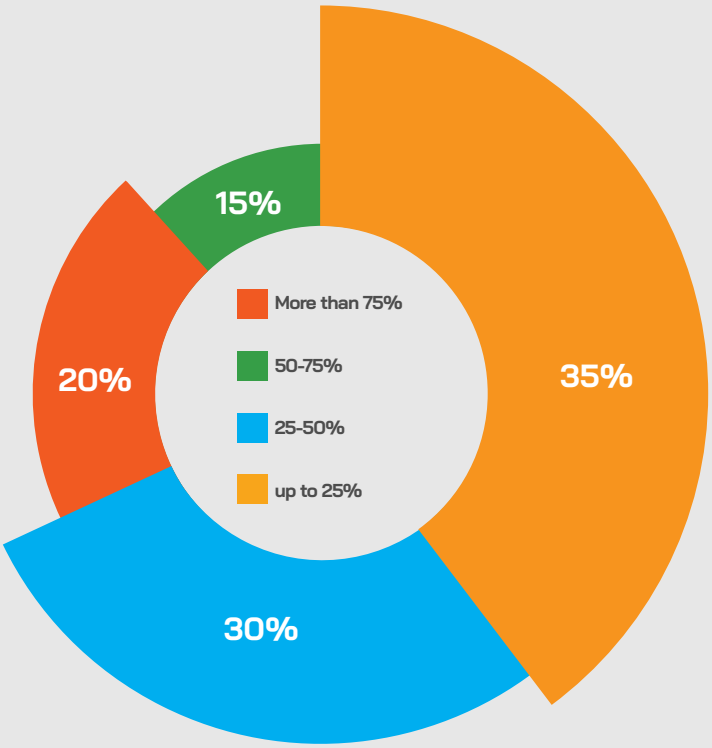
"This gels with the widely increasing requirements for asset managers to properly disclose their sustainability policies and procedures," she concluded. "Asset managers for so long have been consumers of disclosures by listed companies, and now they're increasingly being asked to make disclosures themselves. And this is consistent with what we are seeing from the EU, with their many rules. I think everyone is going to be on notice, to be honest."

Regulation – inexorable global tightening

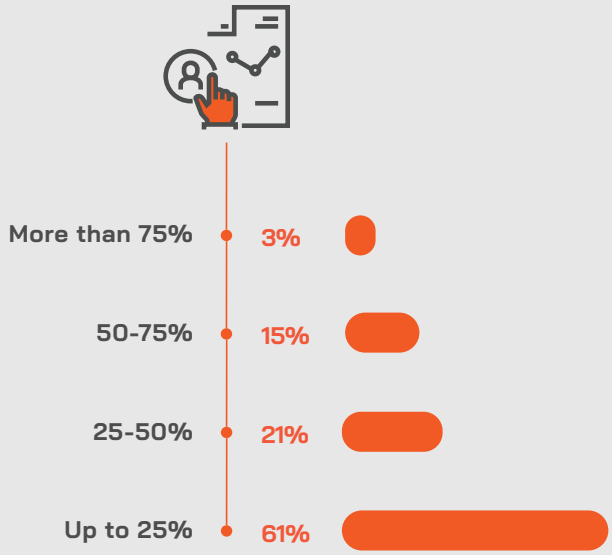
She explained that the firm works closely with regulators on policies, especially in relation to issuer disclosures as well as on increasingly asset manager disclosures. And also noted that as the concerns over 'greenwashing' increase, more and more regulators are intensifying their scrutiny of investment products, and issuer disclosures.

Another guest told delegates he agreed with these comments and others from fellow panel experts that regulation will be a key driver and directly influence how investors react, how asset managers structure their products, on the regime around disclosures, and so forth.

WHAT PERCENTAGE OF ANY WELL-MANAGED EQUITIES INVESTMENT PORTFOLIO FOR ASIAN UHNW AND HNW CLIENTS SHOULD BE SELECTED BASED ON ESG CRITERIA?



AND ROUGHLY WHAT PERCENTAGE OF EQUITIES INVESTMENT PORTFOLIO FOR ASIAN UHNW AND HNW CLIENTS ARE TODAY DETERMINED BASED ON ESG CRITERIA?



"We will see what happens when the European Union introduces SFDR, or the Sustainable Finance Disclosure Regulation, in 2022," he said. "This imposes mandatory ESG disclosure obligations for asset managers and other financial markets participants. And we have the latest EU categorisation or taxonomy also coming out in 2022. In short, we expect to see a gradual tightening of rules coming from the EU."

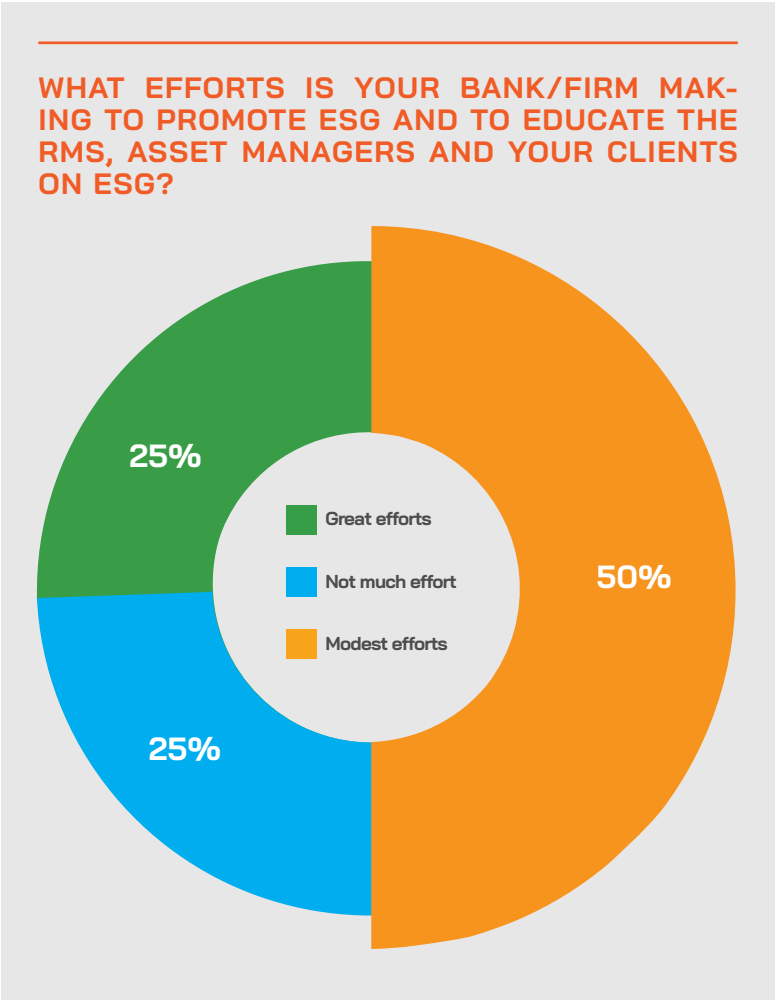
Self-declaration and the burden of proof

He noted that in March 2021, European funds needed to self-register on disclosing the integration of ESG factors or non-financial factors into their investment processes. And next year, European registered funds will have to disclose certain metrics, for example on carbon emissions, the carbon footprint, and so forth. He said that on top of all that, the EU taxonomy will be aligned with the EU 'Green Deal', which also requires that at the individual investment level, a certain amount of disclosure must be made.

"Put simply," he said, "the EU is going to demand proof of claims made, so for example, if you say you are launching a sustainable green fund, you will need to demonstrate some hard numbers around that And on top of all this, Europe also has the task force on climate-related financial disclosure, which is one of the rule-makers for asset managers investing in climate change or decarbonisation, with the recommendations arriving just recently in June."

Different regulatory approaches, with similar aims

He also commented that in the US, the approach from the SEC is a more 'naming and shaming' attitude to regulation, at least so far. "Both the US and European approaches really result in the same thing, which is putting asset managers or banks to account for their own responsibilities and more broadly fighting greenwashing," he said. "As to how Asia approaches all this, I think it will be a combination of both strategies."



Realising and overcoming the challenges ahead

An expert agreed that while there are many ESG cheerleaders, the limitations of ESG should also be fairly recognised. "We know that a key hindrance is that no two people have the same understanding of what ESG means," she said. "I sometimes joke that it's like the old Chinese proverb where people were blindfolded, and they felt different parts of an elephant, but often thought they were touching different parts or even different animals. So, we need to be transparent in claims and objectives."

She observed that some products might have robust ESG qualities, and others might more directly help the environment, or communities. In other words, ESG is not one manifestation, and as intermediaries, the investment management community needs to be able to articulate and explain some of these features in way that are understandable to the clients because different clients will have different objectives.

Hurdling the current limitations and objections

A guest reported that in all the surveys that they had conducted globally in the last few years, those polled had consistently said that their lack of ESG integration into their investment process was driven by two key factors.

"We see two key impediments that they cite," she said. "First, we find that they refer to the lack of real client demand, and secondly, the lack of knowledge. It is the second of these that we can really help with but addressing this will help drive demand."

She said that the lack of know-how is going to be a major recurring feature, especially in Asia-Pacific, and we may think that it is not so vital currently because client demand may not yet be there. "However, we know that clients in APAC are very savvy, and it is only a matter of time that they're going to turn around and demand this of their investment funds and advisors," she said. "So, we think now is the best time to be building that track record and building up that capability."

Seeing reality through the mists of the claims

Expanding on the topic of the limitations of ESG, and addressing negative comments from detractors, an expert observed that at the entry level, ESG is really fairly simple, in that it helps filter out the more controversial investments.

"But then, when you delve deeper into the data, it does honestly become more difficult to penetrate," he conceded. "For example, there's a massive premium for large cap stocks; they have more resources, they provide the ratings specialists with more data, and therefore their scores tend to be better. Hence, a large cap portfolio will have better scores than a very equivalent selection of mid and smaller cap companies. Ergo, the comparisons to companies with smaller resources might not actually be that accurate or useful."

Expert Opinion

MAXIME PERRIN, Head of Sustainable Investment, Lombard Odier Investment Managers

"At Lombard Odier, we advise clients on how best to invest in the sustainable transition, while helping companies improve their preparedness through engagement and proxy voting. More crucially from a financial point of view, we help our clients invest in the climate transition with the aim of minimising risk and maximising returns. This means that we help investors identify through forward-looking metrics how prepared and credible companies are in their plans for decarbonisation. Lombard Odier also offers its clients thematic investment exposure through funds dedicated to ESG themes, such as the Climate Transition fund (dedicated to capturing growth from net-zero economy) and the Natural Capital fund (investing in the circular bio-economy and leaner form of industry)"

Diversity of ratings approach is healthy

He extrapolated from this observation to say that one needs to look under the hood of the ESG scores to their actual meaning.

"If you take the two or three largest ESG data providers, they have slightly different methodology, and slightly different questionnaires," he reported. "One of them might rate Tesla highly, another much lower. But in my view, that does not weaken the credibility of ESG; we need to look at these metrics without the kind of dogmatism that some ESG proponents have. It needs to be looked at for what it is, which is a huge amount of very useful and important non-financial data that the investment managers can use to inform their decisions."

He also commented that ESG is also very valuable in determining which companies are more in line with strong regulation, because they are likely to be less subject to regulatory friction. "Therefore, it's in everybody's interest for the engagement and proxy voting rules that we apply to reflect these ESG values," he said.

Tailoring ESG-centricity to client demand

"Some clients may be happy just that ESG is integrated loosely in the product," another expert observed, "while some may want to go further, and for example, some may actually be prepared to give up some return in order to see more impact. And all this needs to be framed in the larger picture of wealth protection and savings for the future."

Also on the client side, a guest explained that clients have varying degrees of demands and expectations. For example, he said a

client had asked for a portfolio only in sustainable food, clean energy, health, and technology, and that portfolio is now available to all their clients. "We build the best we can for their specific objectives, while for others who are less interested in ESG, we incorporate it in their portfolios, because we believe there's an investment benefit."

Looking forward

An expert closed his observations and the discussion by reiterating his earlier comment that ESG is rated based overwhelmingly on past data, but that if investors seek to identify the companies undergoing sustainability transition, they need access to forward-looking guidelines.

He said they need to be able to identify which companies are carrying a misunderstood or mispriced risk with regards to decarbonisation, for example, or climate change more broadly, risk that comes through stranded assets, regulatory friction, falling margins, a lack of competitive advantage, different levels of financial costs, and so forth. "That process opens the window to see more risk and more opportunity," he reported.

He elaborated on this, noting for example that a corporation in a sector with high CO2 emissions knows the regulators are coming and that the world is going to be a much more difficult place to emit CO2 over the next 5, 10 and 15 years. Similarly, for companies in industries such as steel, cement, plastics, chemicals, transport, utilities, investors need to be able to identify clearly which companies have credible plans to reduce environmental impact.

The survival game

He concluded that investors can then get nearer to identifying those which are likely to not only survive, but gain market share, even probably have greater pricing power. "And you can see those companies that are behind the game, perhaps just hoping they will be rescued by some kind of new technology that will save them from annihilation by the regulator, or by competition," he said. "I am exaggerating somewhat to make my point, but what we do know very clearly is that there are massive opportunities and substantial risks that we should look at."

And the panel concluded that ESG metrics and ratings, albeit imperfect as they are today, offer a wonderful prism through which we are more likely to spot those hazards and help investors seize on the many great opportunities ahead. ■