

# Sustainable investment really sustainable ?

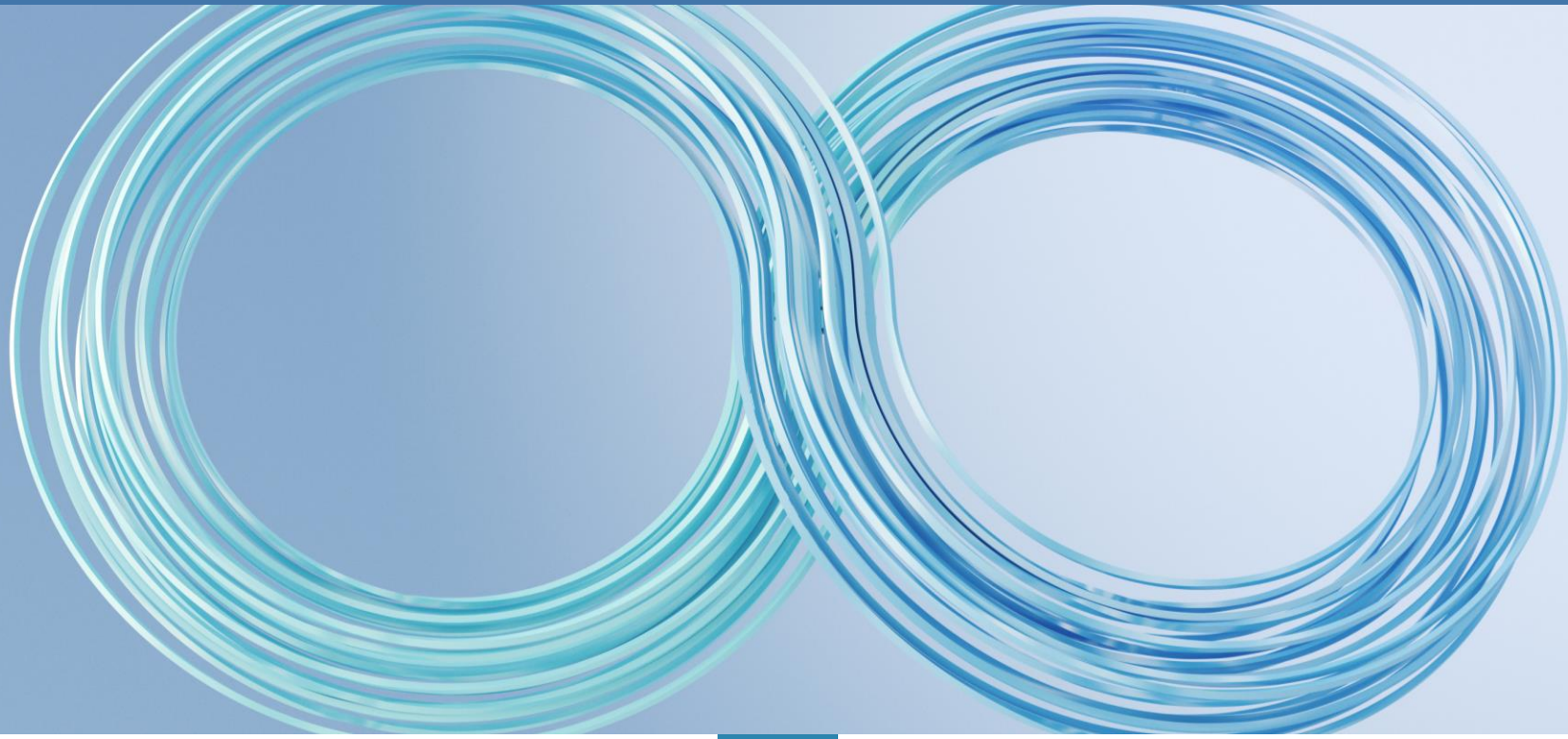
Nelson Huang

Navigate Investment Consultant  
2021 DEC



# Agenda

- Development of sustainable investment
- ESG investment process sample
- ESG data provider rating methodologies
- How to find alpha through ESG



# Development of sustainable investment



# Awareness Stage

- Principles for Responsible Investment (UNPRI or PRI) is a United Nations-supported international network of investors working together to implement its six aspirational principles, often referenced as "the Principles"
- Earliest back to 2005, and then got supported by UN. Became the most influenced institute to promote responsible investment
- VOLUNTARY signatory to obey PRI principles, now 3,415 investment managers signed
- The first and very basic step to entry sustainable investment field

*Signatory of:*



# Action Stage

- The Sustainable Development Goals (SDGs) or Global Goals are a collection of 17 interlinked global goals designed to be a "blueprint to achieve a better and more sustainable future for all"
- Setup in 2015 by UN, and are intended to be achieved by 2030
- In 2017, setup specific targets for each goal, along with indicators that are being used to measure progress toward each target
- Active fund houses start to launch SDG/Impact funds invest companies could help to reach the SDG targets since 2015



# Regulatory Stage

- The EU taxonomy for sustainable activities is a classification system established to clarify which investments are environmentally sustainable. The aim of the taxonomy is to prevent greenwashing and to help investors make greener choices.
- Investments are judged by six objectives: climate change mitigation, climate change adaptation, the circular economy, pollution, effect on water, and biodiversity.
- The taxonomy regulation came into force in July 2020, and followed by Sustainable Finance Disclosure Regulation (SFDR) in March 2021



# SFDR | Article 6 , 8, 9 and roadmap

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## ESG Basic Consideration

Not required to specify with ESG actually and need to be clearly labelled as non-sustainable.

However, most fund house would illustrate they would do basic ESG exclusion. (tobacco, adult..etc)

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## ESG Positive Impactor

Align to a least one of the Taxonomy criteria. Any Article 9 Funds with a carbon reduction objective will potentially have to track an EU Climate Transition Benchmark or EU Paris-aligned Benchmark.

Make real positive impact with clear objective while constructing portfolio.

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## ESG Active Promoter

Promotes environmental or social characteristics, provided that the companies in which the investments are made follow good governance practices

Need solid process to show how integrated the ESG selection into investment.



## SFDR Roadmap

**2022 July** : Disclosure ESG indicators through Adverse Sustainability Impacts Statement (ASIS)

**2023 June** : FMPs (financial market participants) need to report their performance on entity level on various ESG indicators accompanied with textual explanations and commentaries through ASIS

**2024 June** : A final complete report of ASIS



# Current status of SFDR and Taiwan related actions

- Based on SFDR data collected from prospectuses, available for sale in the EU, updated to 2021Q3
- Since SFDR effective in March, Article 8 & 9 funds attracted more than 50% fund flow
- Article 8 funds represents 33% of fund asset, Article 9 funds represents 3.9%
- Morningstar expect Article 8 & 9 funds would reach 50% of total fund asset by mid-2022



- Taiwan FSC announce 8 principles to review onshore ESG fund application in July
- 4 funds has got approval after the new regulation, expect more ESG funds would apply
- Previous ESG funds need to provide more information to keep in ESG funds pool by 2022Jan
- Investors could check recognized ESG funds on MOPS onshore fund platform





# ESG investment process sample

# Traditional ESG frameworks do not reflect what really matters

ESG data encompass a wide range of issues that affect industries unevenly



ENVIRONMENT



SOCIAL



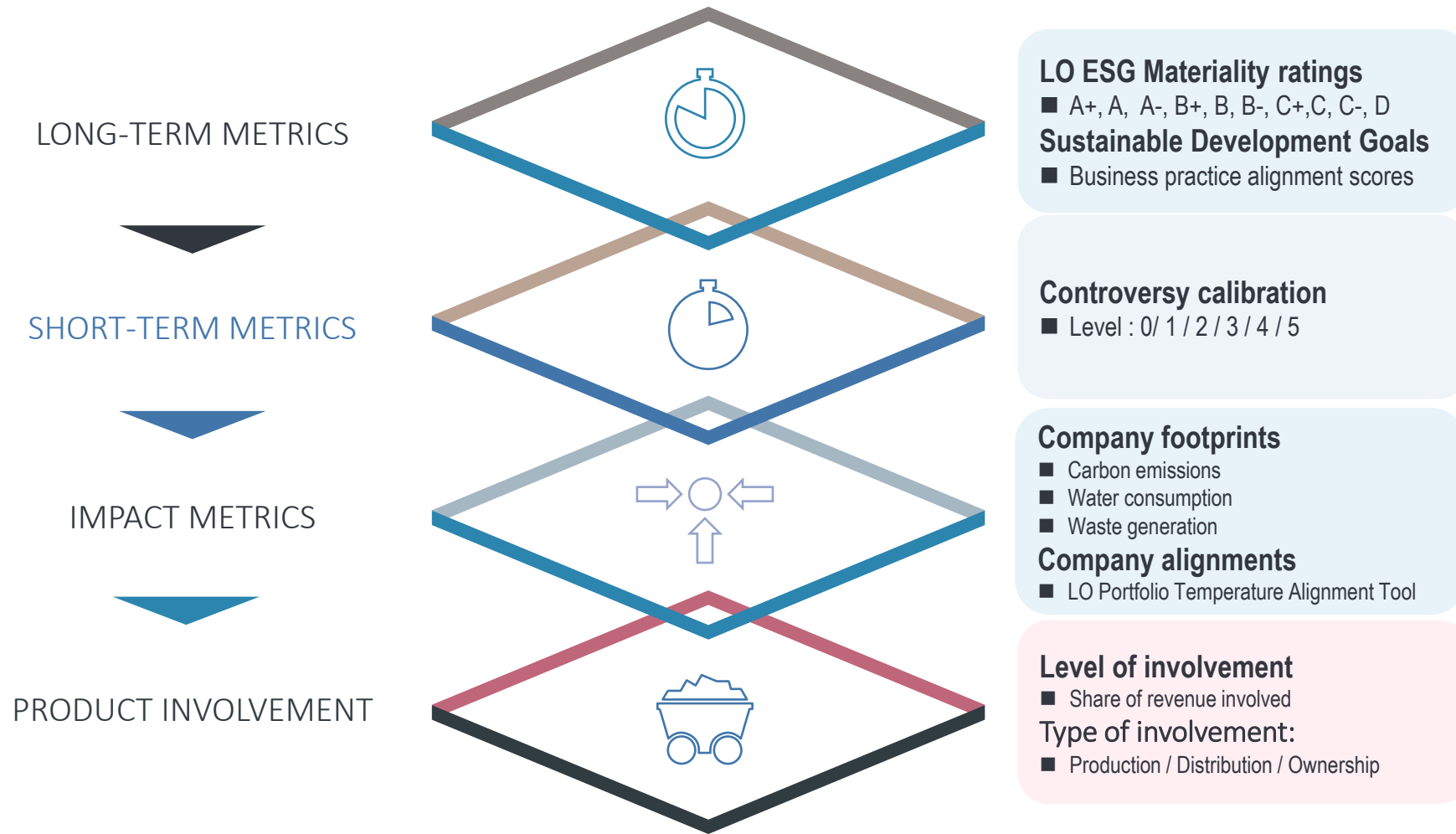
GOVERNANCE



ESG information needs to be reorganised to better reflect how different issues affect each industry

# Assessing the how: business practices

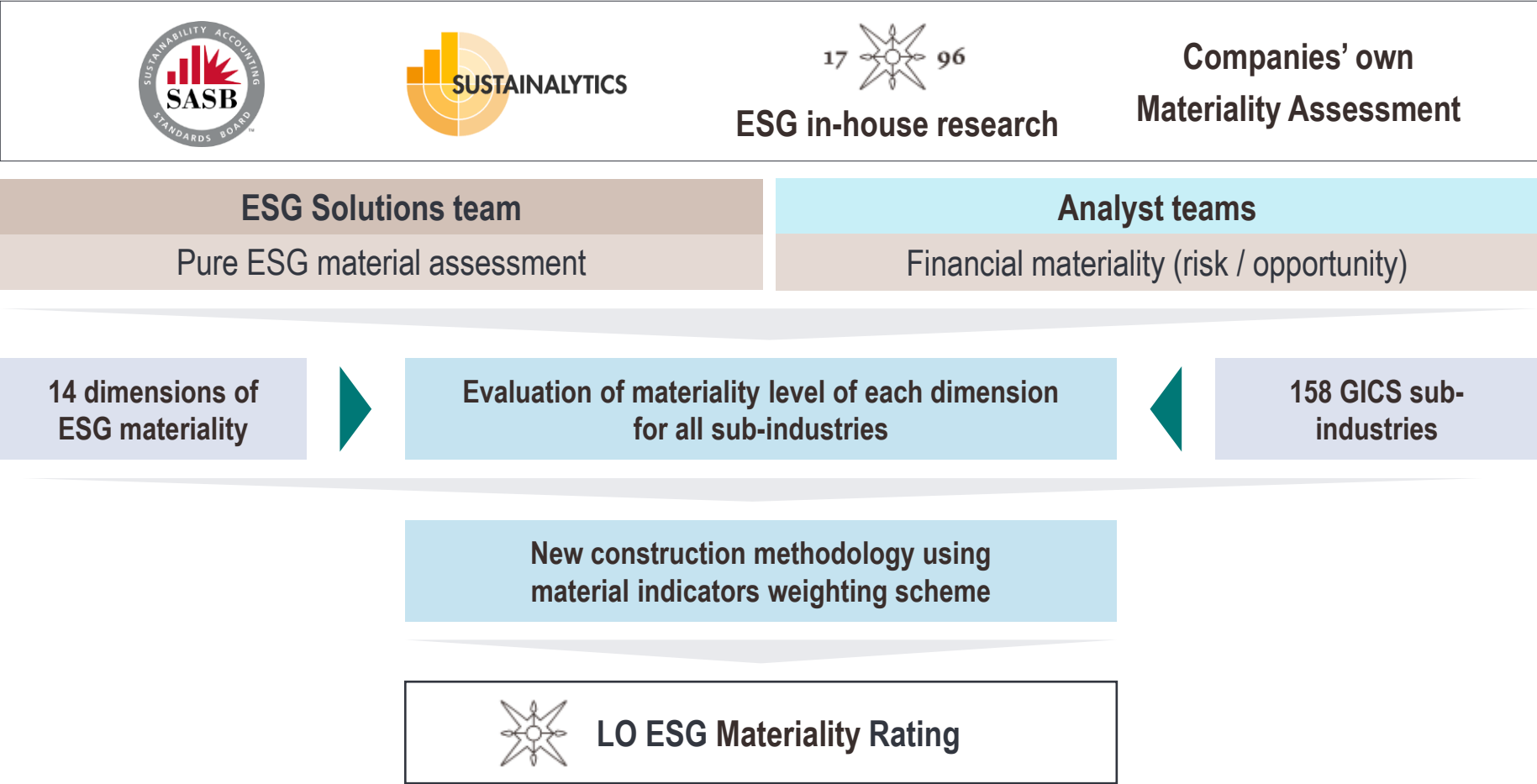
Four-layered approach to ESG analysis





# How construct the LO ESG Materiality framework

Materiality assessment methodology



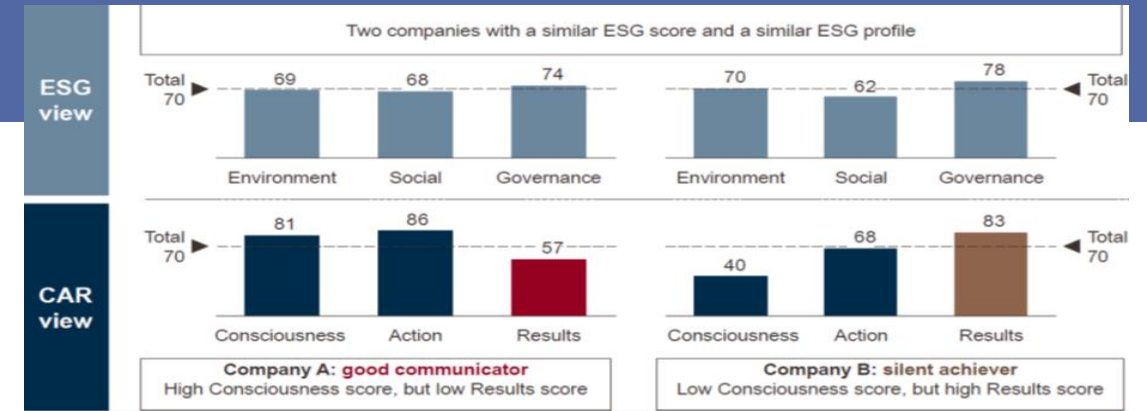
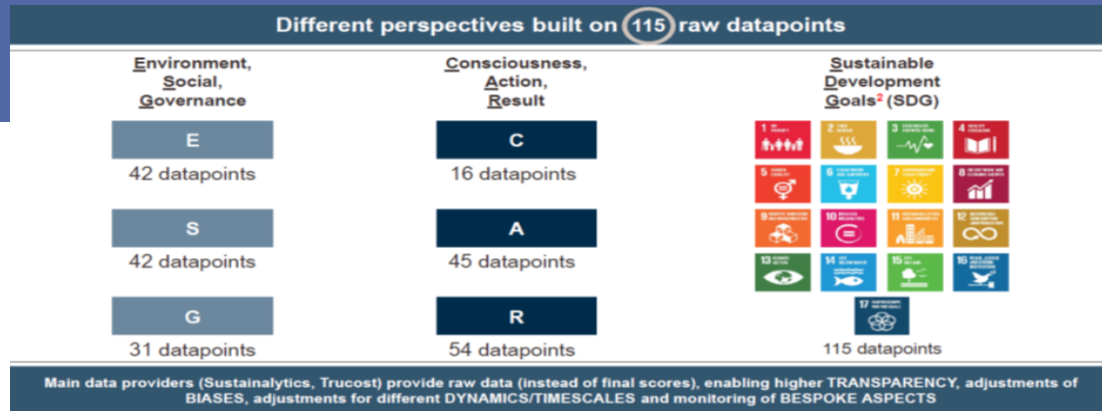
# LO ESG Materiality Heatmap

The material dimensions mapped across 158 GICS Level 4 sub-industries



GICS name	Key: <span>□ Slightly material</span> <span>□ Mildly material</span> <span>□ Material</span> <span>■ Highly material</span>												
	Energy	Chemicals	Metals & mining	Transport & Infra	Automobiles	Consumer Services	Retailing	Health Care	Pharma	Banks	IT Hardware	Renewable Electricity	Real Estate
Business ethics	□	□	□	□	□	□	□	□	□	■	□	□	□
Corporate governance	□	□	□	□	□	□	□	□	□	■	□	□	■
Data management	□	□	□	□	□	□	□	□	□	■	■	□	□
ESG integration	□	□	□	□	□	□	□	□	□	□	□	□	□
Employee health and safety	□	□	□	□	□	□	□	□	□	□	□	□	□
Environmental impact of products and services	□	□	□	□	■	□	□	□	□	□	□	□	□
GHG emissions and energy consumption	■	□	□	□	□	□	□	□	□	□	□	□	□
Human resources management	□	□	□	□	□	□	□	□	□	□	□	□	□
Impact on local communities	□	□	□	□	□	□	□	□	□	□	□	□	□
Pollution and waste	□	□	□	□	□	□	□	□	□	□	□	□	□
Quality and safety of products and services	□	□	□	□	□	□	□	□	□	□	□	□	□
Resource use	□	□	□	□	□	□	□	□	□	□	□	□	□
Social impact of products and services	□	□	□	□	□	□	□	□	□	□	□	□	□
Social supply chain management	□	□	□	□	□	□	□	□	□	□	□	□	□

# Proprietary CAR approach go deeper into ESG scoring

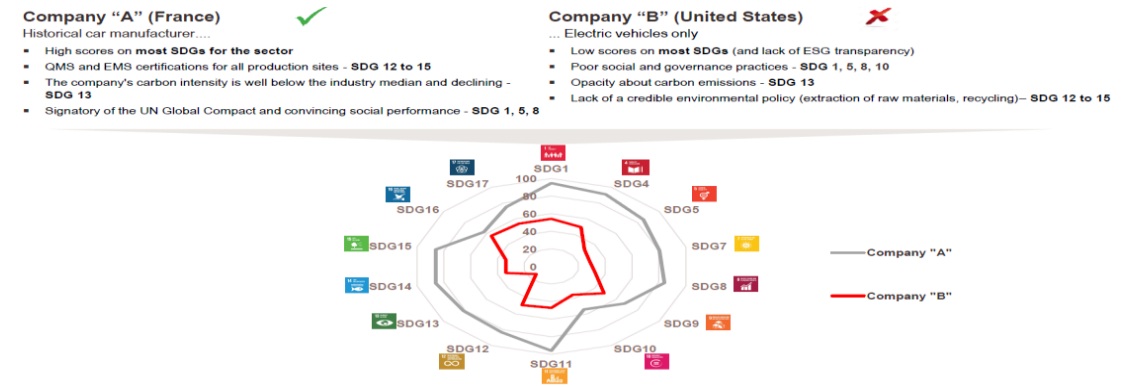


Use data provider raw data to build up in-house model

	E	S	G
<b>'C'</b> Consciousness	<ul style="list-style-type: none"> <li>Environmental policy</li> <li>Green procurement policy</li> <li>Policy statement on GMO*</li> </ul>	<ul style="list-style-type: none"> <li>Discrimination policy</li> <li>Responsible marketing policy</li> <li>Human right policy</li> </ul>	<ul style="list-style-type: none"> <li>Bribery &amp; corruption policy</li> <li>Political involvement policy</li> <li>Money laundering policy</li> </ul>
<b>'A'</b> Action	<ul style="list-style-type: none"> <li>Greenhouse gas reduction, air protection or water management programmes</li> <li>Environmental management system</li> <li>Biodiversity programmes</li> </ul>	<ul style="list-style-type: none"> <li>Community involvement programme</li> <li>Supply chain monitoring system</li> <li>Diversity programme</li> </ul>	<ul style="list-style-type: none"> <li>Whistleblower programme</li> <li>Signatory to the UN Global Compact</li> <li>Independence of board and key committee members</li> </ul>
<b>'R'</b> Results	<ul style="list-style-type: none"> <li>Carbon emissions / water consumption intensity</li> <li>Environmental fines or non-monetary sanctions</li> <li>Share of renewable energy used</li> </ul>	<ul style="list-style-type: none"> <li>Share of facilities with external health and safety certification</li> <li>Social supply chain standards</li> <li>Share of employees covered by collective bargaining agreement</li> </ul>	<ul style="list-style-type: none"> <li>ESG committee with executives members</li> <li>Gender diversity on the board</li> <li>Independence of auditors</li> </ul>

**= 115 data points**

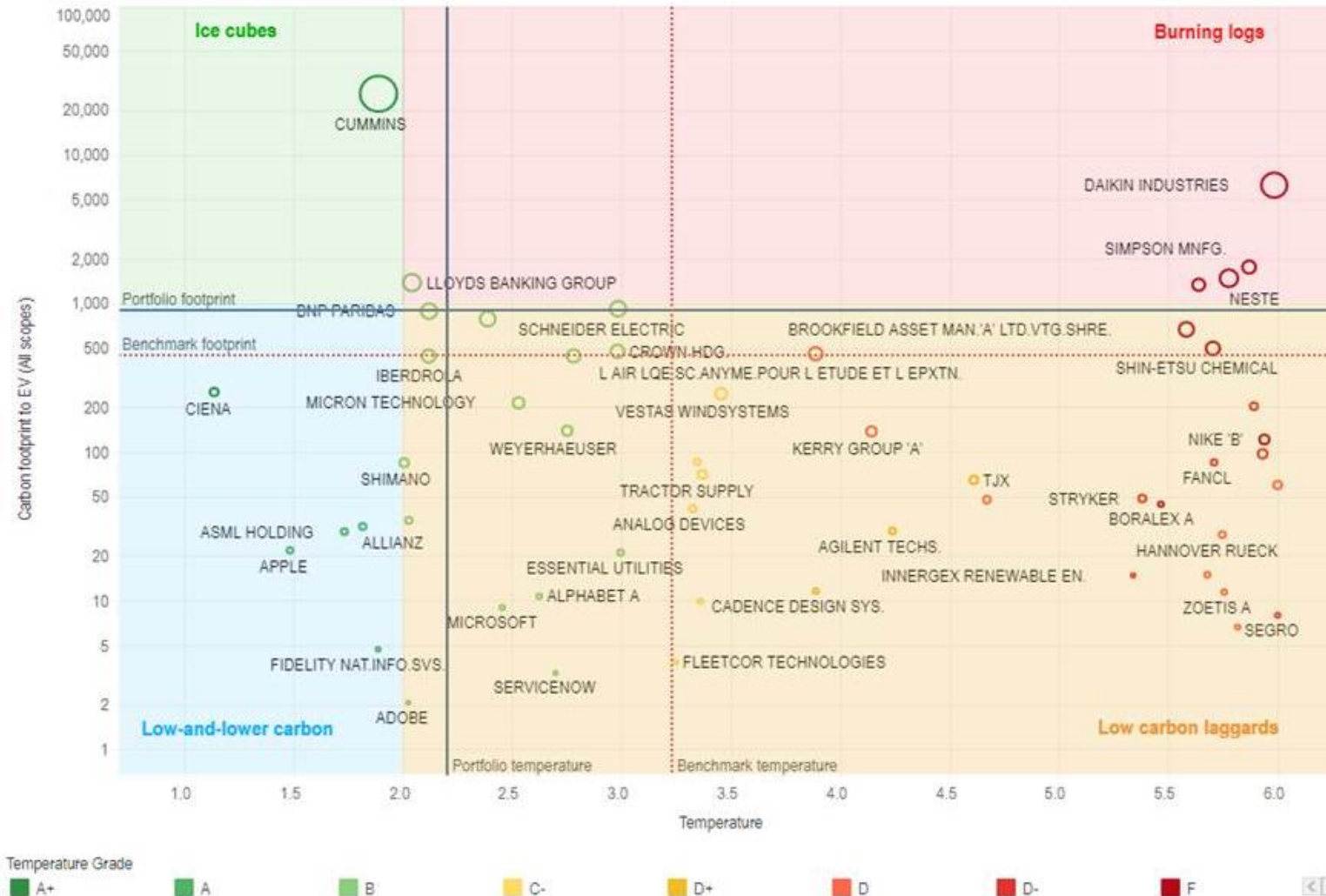
Investment comparison from different angle



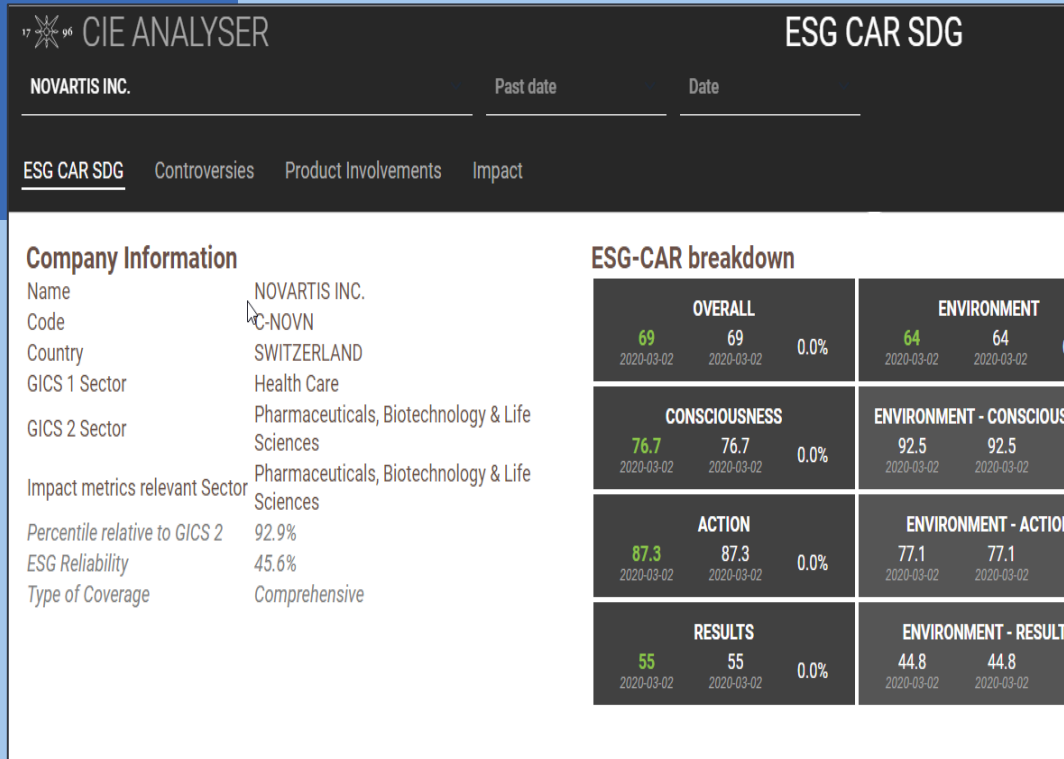


# LO Portfolio Temperature Alignment Tool (LOPTA)

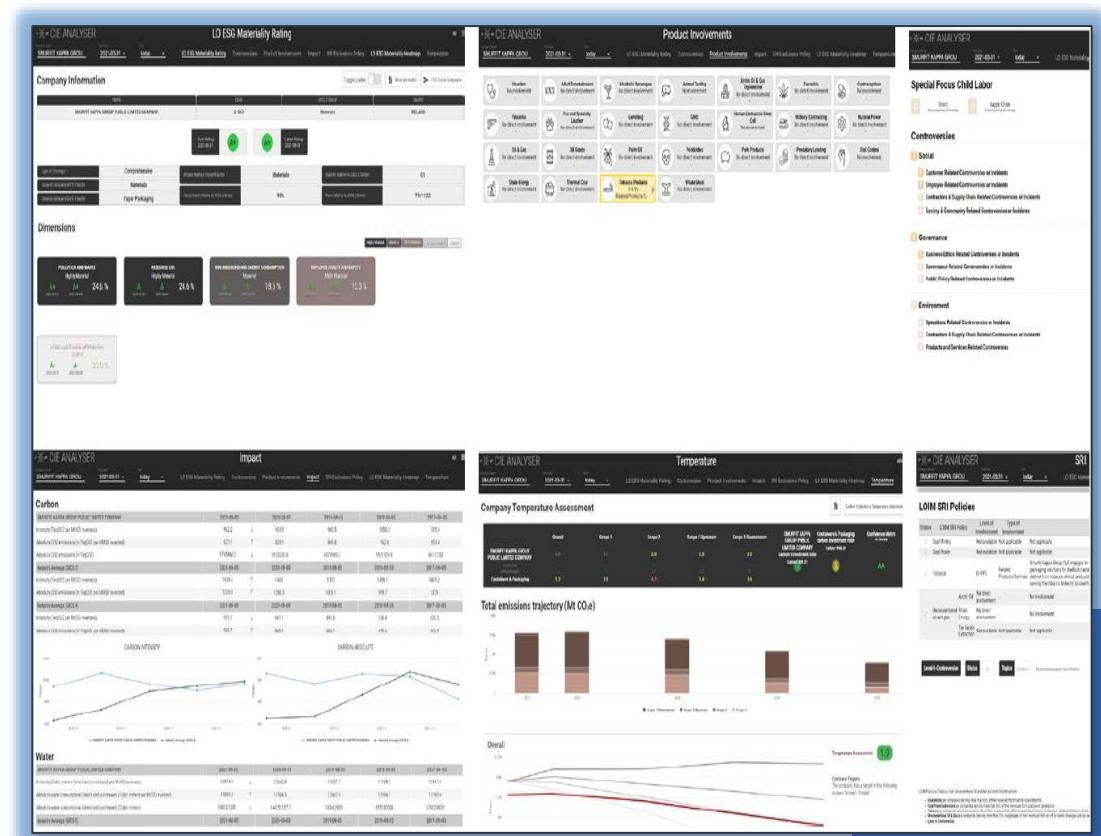
clear view of the risks and opportunities inherent in the climate transition



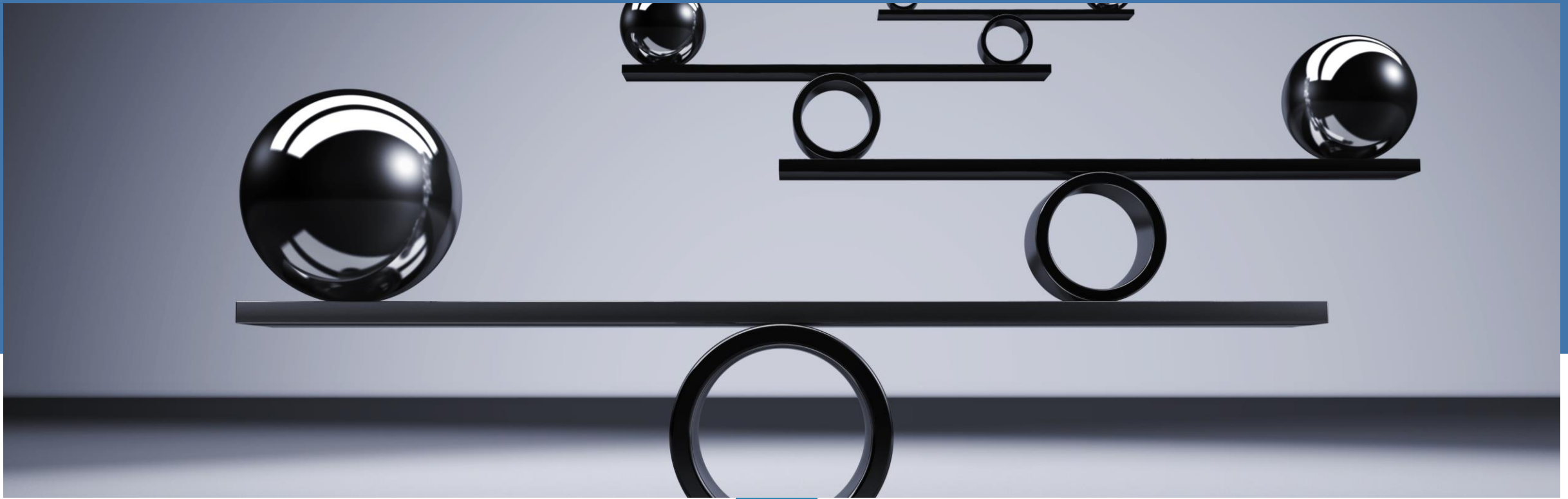
Source: Lombard Odier Investment Managers



## Integrated ESG Materiality rating and research platform



## Internal ESG-CAR scoring output



# ESG data provider rating methodologies



# About ESG data providers

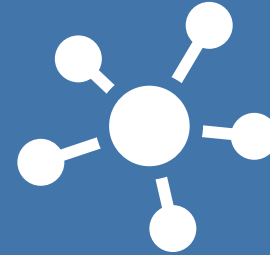


## Common data provider

MSCI ESG  
Sustainalytis / Morningstar  
ISS , CDP , FTSE , S&P ...  
Totally more than 100

## What data provide

Sovereign level  
Company level  
Fund level  
Fund house level  
Custom Index



## Data transparency

Methodology of  
company / fund /  
index  
Data set ?  
Final ESG score

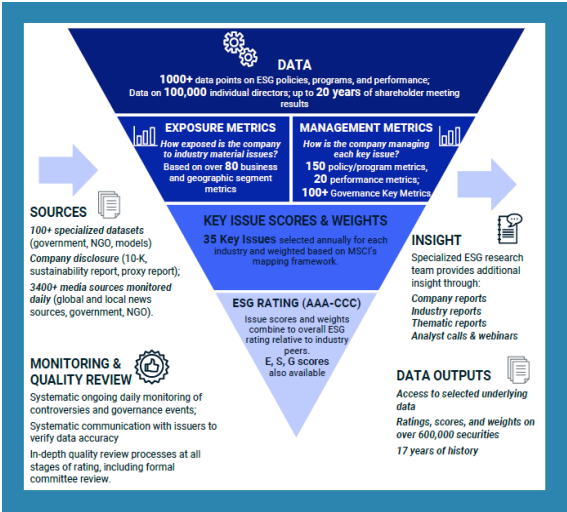
## How to reach data

Some ESG score publish  
on Bloomberg or market  
data system  
Subscribe database to  
get complete content



# MSCI ESG rating methodology

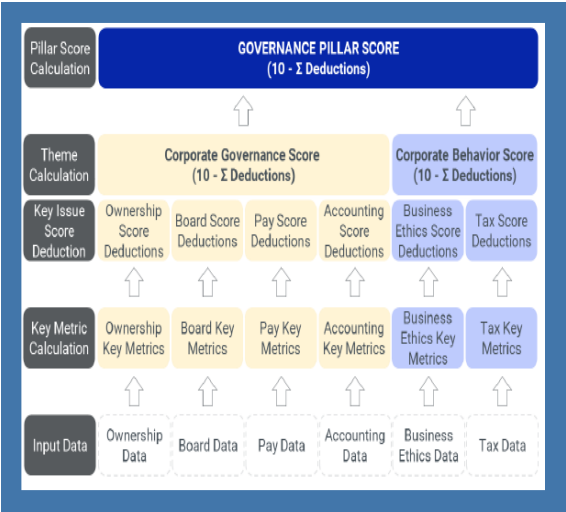
Turning score to letter rating



Exposure and Management Metrics

3 Pillars	10 Themes	35 ESG Key Issues
Environment	Climate Change	Carbon Emissions Product Carbon Footprint Financing Environmental Impact Climate Change Vulnerability
	Natural Capital	Water Stress Biodiversity & Land Use Raw Material Sourcing
	Pollution & Waste	Toxic Emissions & Waste Packaging Material & Waste Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech Opportunities in Green Building Opportunities in Renewable Energy
Social	Human Capital	Labor Management Health & Safety Human Capital Development Supply Chain Labor Standards
	Product Liability	Product Safety & Quality Chemical Safety Privacy & Data Security Responsible Investment Financial Product Safety Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing Community Relations
	Social Opportunities	Access to Communications Access to Finance Access to Health Care Opportunities in Nutrition & Health
Governance*	Corporate Governance	Ownership & Control Board Pay Accounting
	Corporate Behavior	Business Ethics Tax Transparency

ESG Key Issue Hierarchy



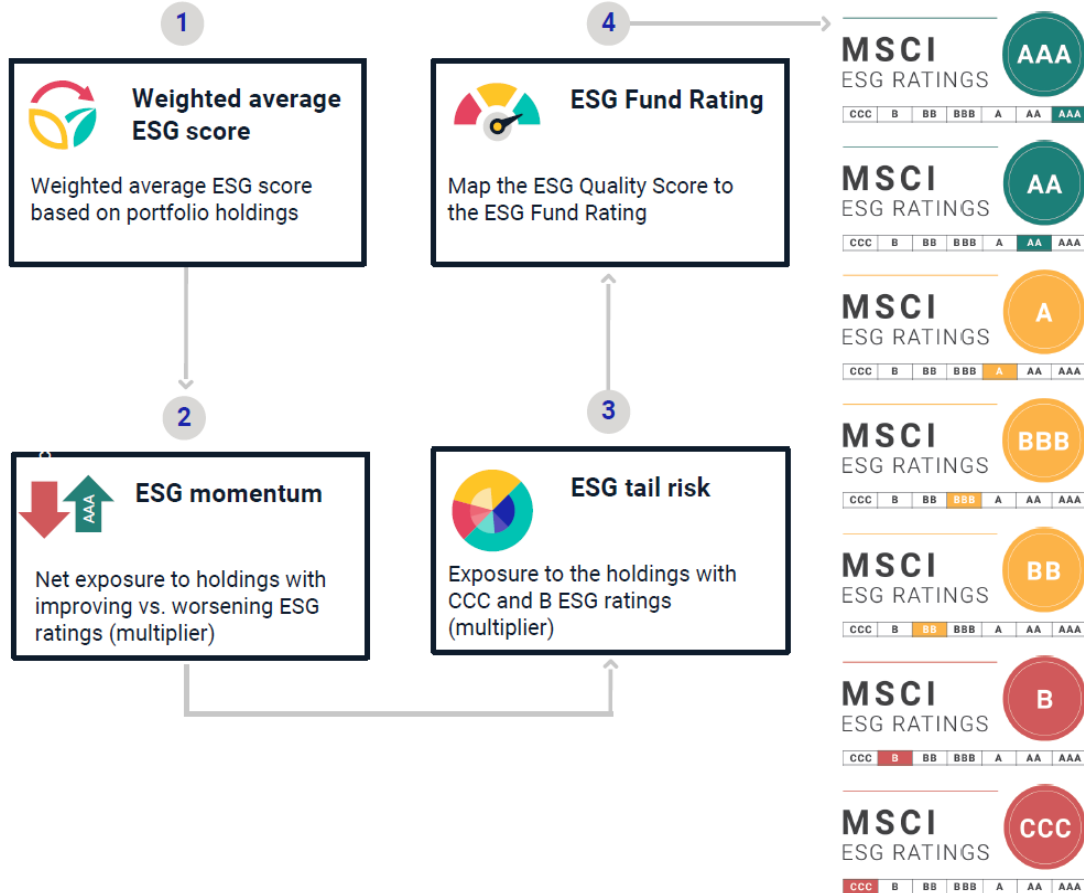
Governance Model Structure

Letter Rating	Leader/Laggard	Final Industry-Adjusted Company Score
AAA	Leader	8.571* - 10.0
AA	Leader	7.143 - 8.571
A	Average	5.714 - 7.143
BBB	Average	4.286 - 5.714
BB	Average	2.857 - 4.286
B	Laggard	1.429 - 2.857
CCC	Laggard	0.0 - 1.429

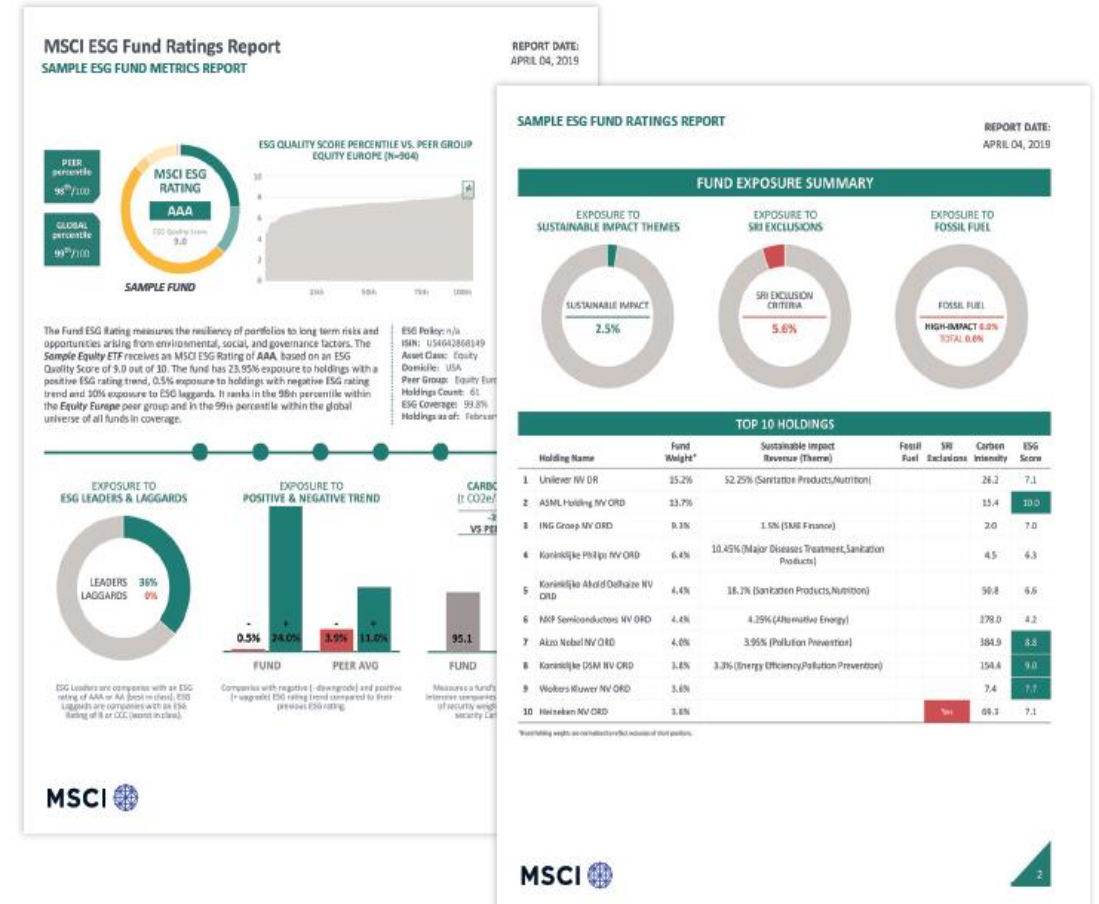
Company Score is mapped to a Letter

Source: MSCI ESG Research

# MSCI ESG Fund Rating Methodology



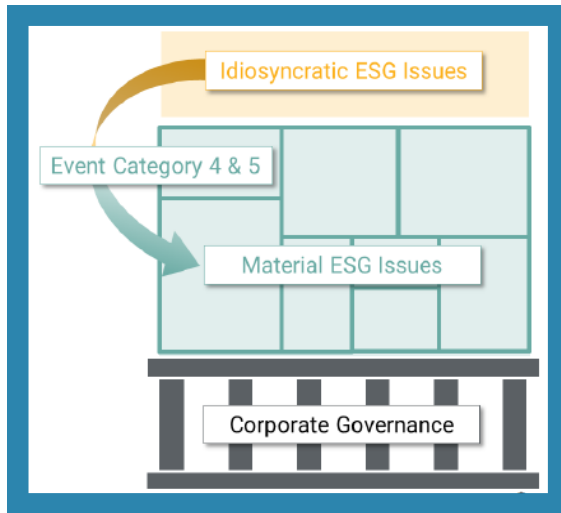
# MSCI ESG Fund Rating Report



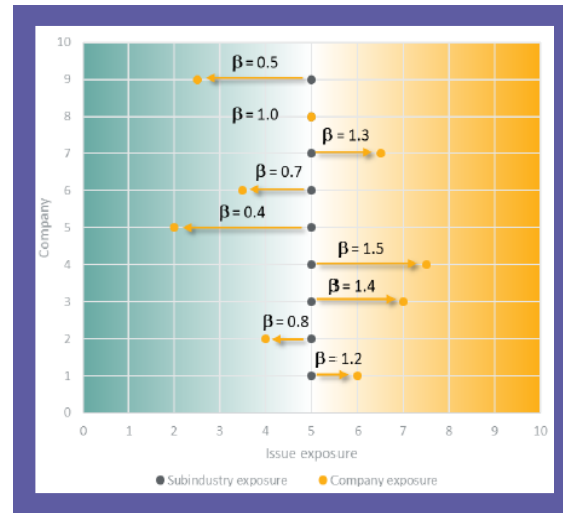


# Sustainalytics ESG scoring methodology

Use unmanaged risk as final score (higher number, poor ESG)



Three building blocks of ESG Risk Ratings



Using beta concept to assess company-specific exposure

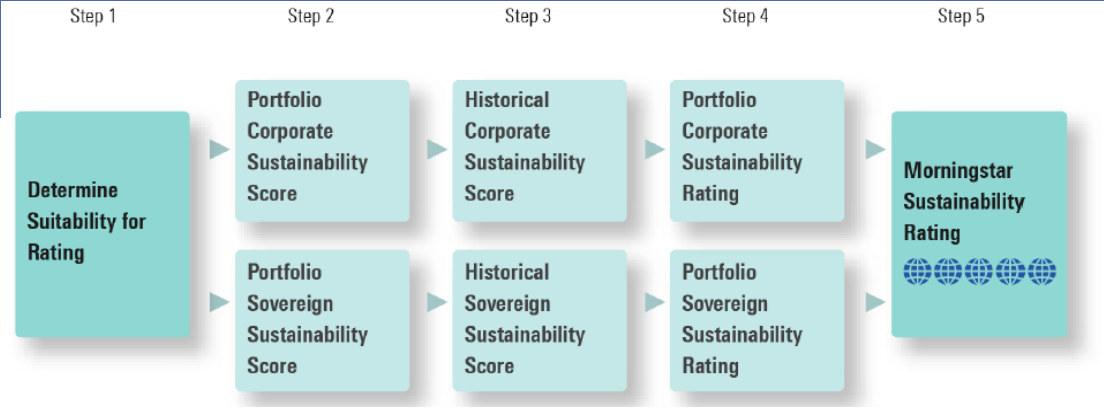
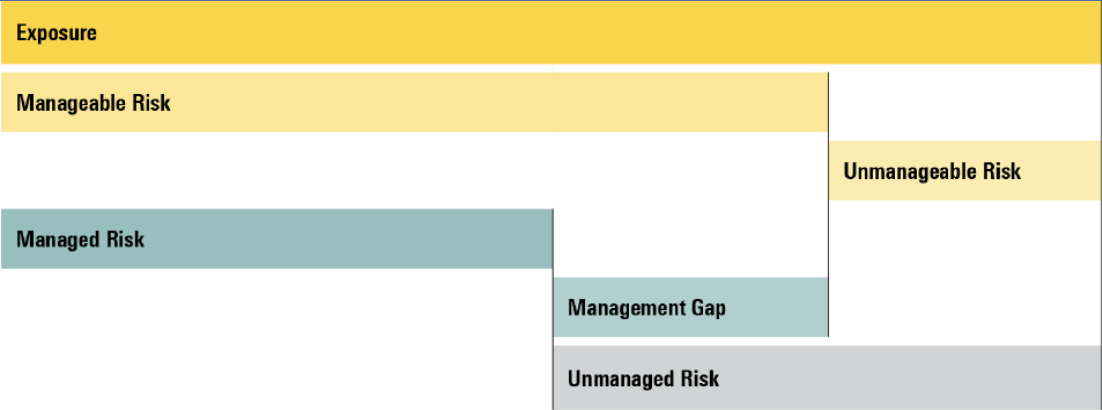


Model for calculating issue betas

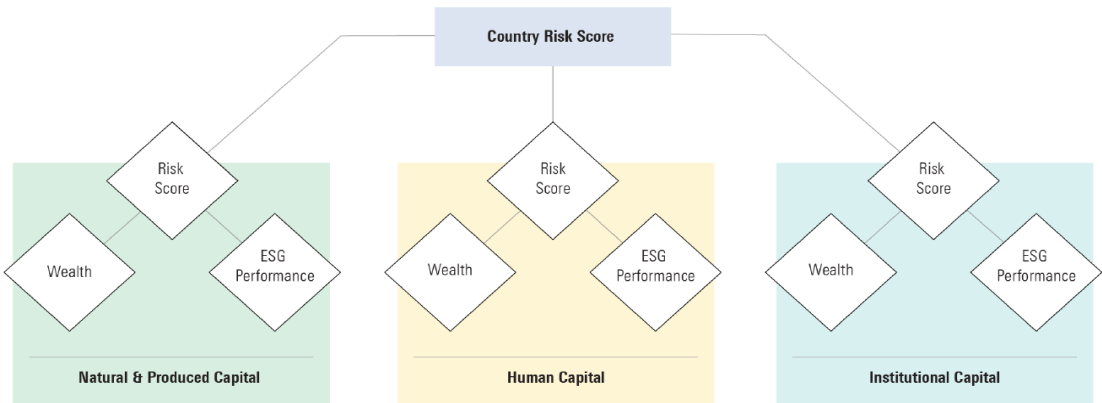
<b>Company Exposure</b>	=	Subindustry Exposure	*	Issue Beta	
	=	8	*	1.5	= 12
<b>Manageable Risk</b>	=	Company Exposure	+	MRF	
	=	12	+	90%	= 10.8
<b>Managed Risk</b>	=	Manageable Risk	*	Management score (as %)	
	=	10.8	*	75%	= 8.1
<b>Unmanaged Risk</b>	=	Company Exposure	-	Managed Risk	
	=	12	-	8.1	= 3.9

ESG Risk Ratings – the scoring structure

# Morningstar sustainability rating for funds methodology



## ESG risk ratings for company and country risk ratings



## Combining corp and sovereign ratings in whole portfolio

Corporate Sustainability Rating	Corporate Contribution %	Sovereign Sustainability Rating	Sovereign Contribution %	Morningstar Sustainability Rating	Combined Corporate and Sovereign Rating	Rating Icon
4	50	2	50	3	$\geq 4.5$	
4	80	2	20	4	$< 4.5 \text{ AND } \geq 3.5$	
4	20	2	80	2	$< 3.5 \text{ AND } \geq 2.5$	
					$< 2.5 \text{ AND } \geq 1.5$	
					$< 1.5$	

# MSCI Climate Change Indexes Methodology

The indexes apply an heuristics-based approach in order to meet the following objectives:

- Minimum 30% reduction in Greenhouse Gas (GHG) intensity (Scope 1+2+3) relative to the Reference Index
  - Potential emission intensity 30% lower
  - Neutral exposure to high impact sector
- Increases weight in companies which see opportunities from climate transition
  - 3x category tilt score for companies in Solutions LCT Category (green companies) to the parent index
- Annual decarbonization at 7% starting June 1st 2021 (base date)
- N/A
- 

Weight Tilt - Combined Score - Category Tilt Score \* Relative Tilt Score

# MSCI Climate Paris Aligned Indexes Methodology

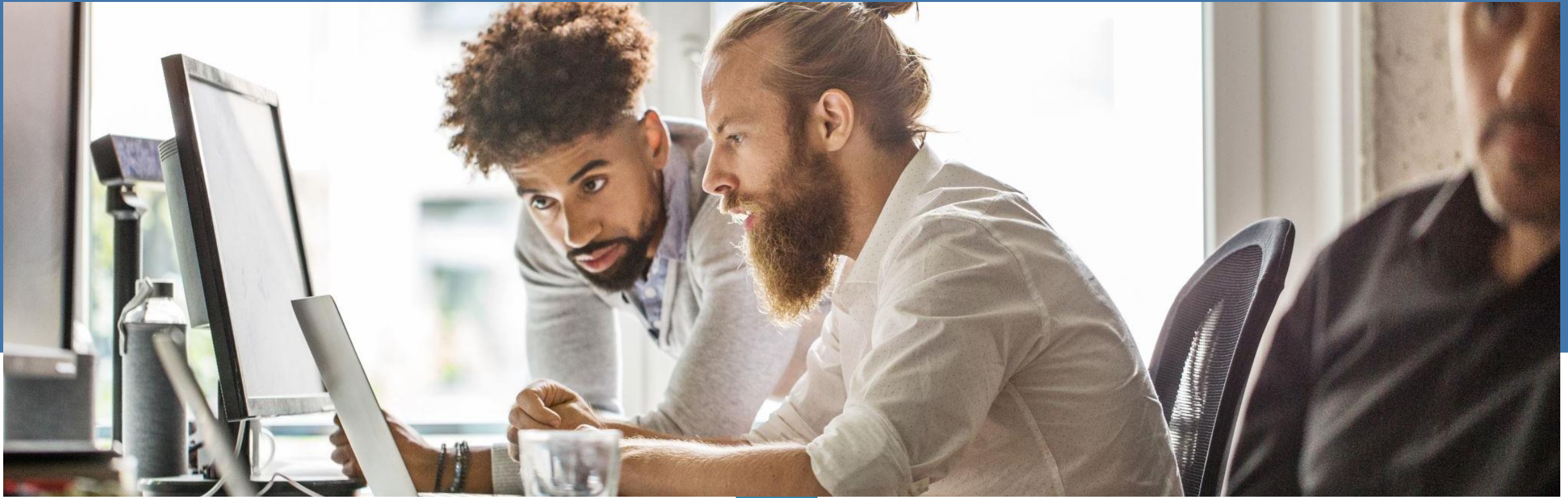
ESG	TRANSITION RISK		GREEN OPPORTUNITY	1.5°C ALIGNMENT	PHYSICAL RISK
Controversial Weapons	Carbon intensity reduction (Scope 1, 2 and 3)	Neutral exposure to high impact sector	At least double the Green Revenue exposure	Self-decarbonization at 10%	Physical Risk Climate VaR is at least 50% lower
Societal norms violators	Immediate Scope 3 phase-in	Higher allocation to companies with credible emission reduction targets	Green/fossil fuel-based ratio – 4x higher than parent	Neutral Aggregate Climate VaR under 1.5°C Scenario	
MSCI ESG Controversy Score	Underweight companies facing transition risk	Significant improvement in Low Carbon Transition (LCT) Score	Overweighting of companies providing solutions		
	Lower fossil fuel exposure	50% minimum reduction in Potential Emissions Intensity			
Minimum requirement by the EU Benchmark Regulation		Additional criteria achieved by the MSCI Climate Paris Aligned Indexes			

# Comparison of ESG data providers

- Support for key regulations varies
- All models apply simplified assumptions and therefore reduce the relevance of results
- The aggregation of data is not always transparent
- There is a lack of correlation between ESG scores
- No solution can model all asset classes
- The lack of available ESG data is a major challenge for data providers and financial services firms alike

Data solution		Number of data providers offering that type of solution
Regulation Coverage	SFDR	14; 5 new providers expected end of year 2021
	EU Taxonomy	12; 7 new providers expected end of year 2021
	TCFD	18; 2 new providers expected end of year 2021
	SDG Alignment	21; 5 new providers expected end of year 2021
Data Coverage	ESG Scoring	30
	ESG Indices	19; 1 new providers expected end of year 2021
	Raw Data/ Data Analytics	36
	Supply Chain	18
	Sentiment Analysis	12; 1 new providers expected end of year 2021
Modelling Coverage	Net Zero	16; 1 new providers expected end of year 2021
	Climate Risk Modelling/Stress Testing	26; 2 new providers expected end of year 2021
	Biodiversity	4; 3 new providers expected end of year 2021



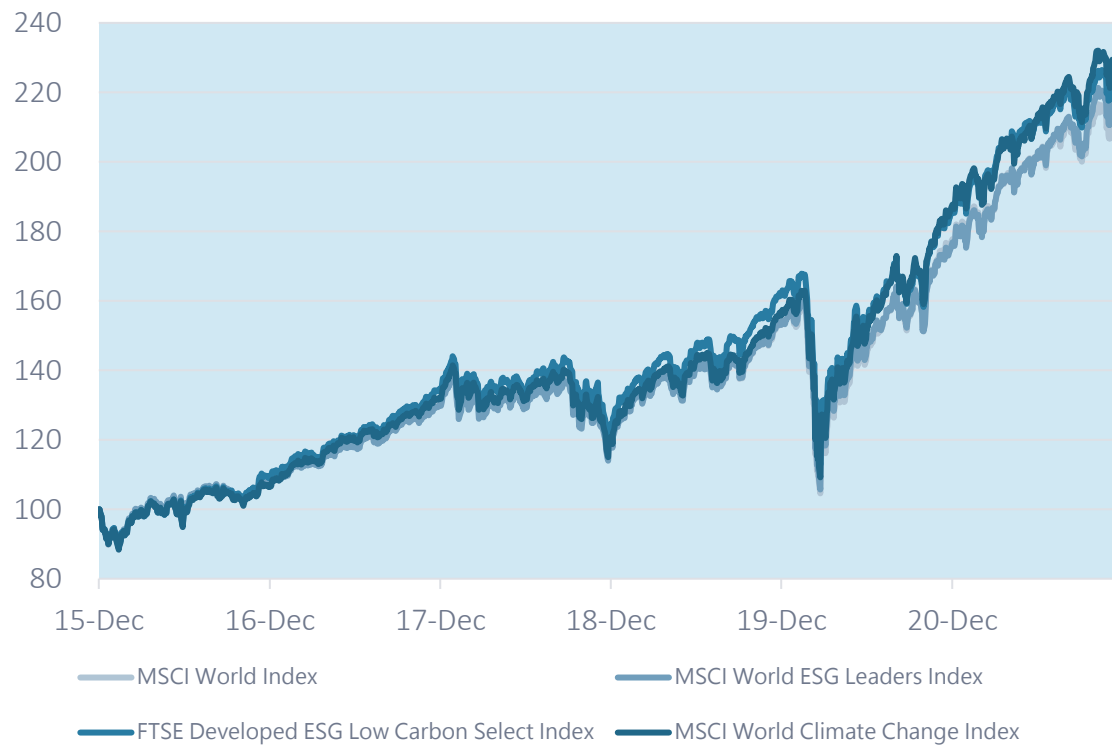


# How to find alpha through ESG

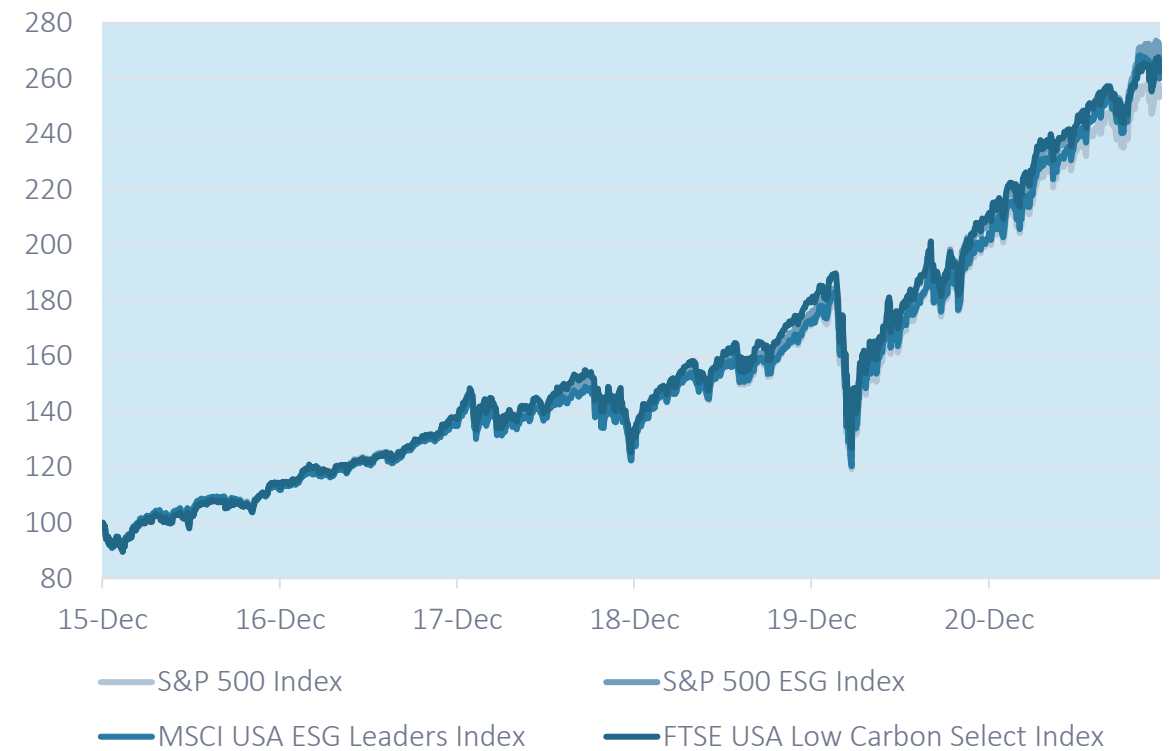


# ESG concept index all look like the same

## World index with different ESG thematic



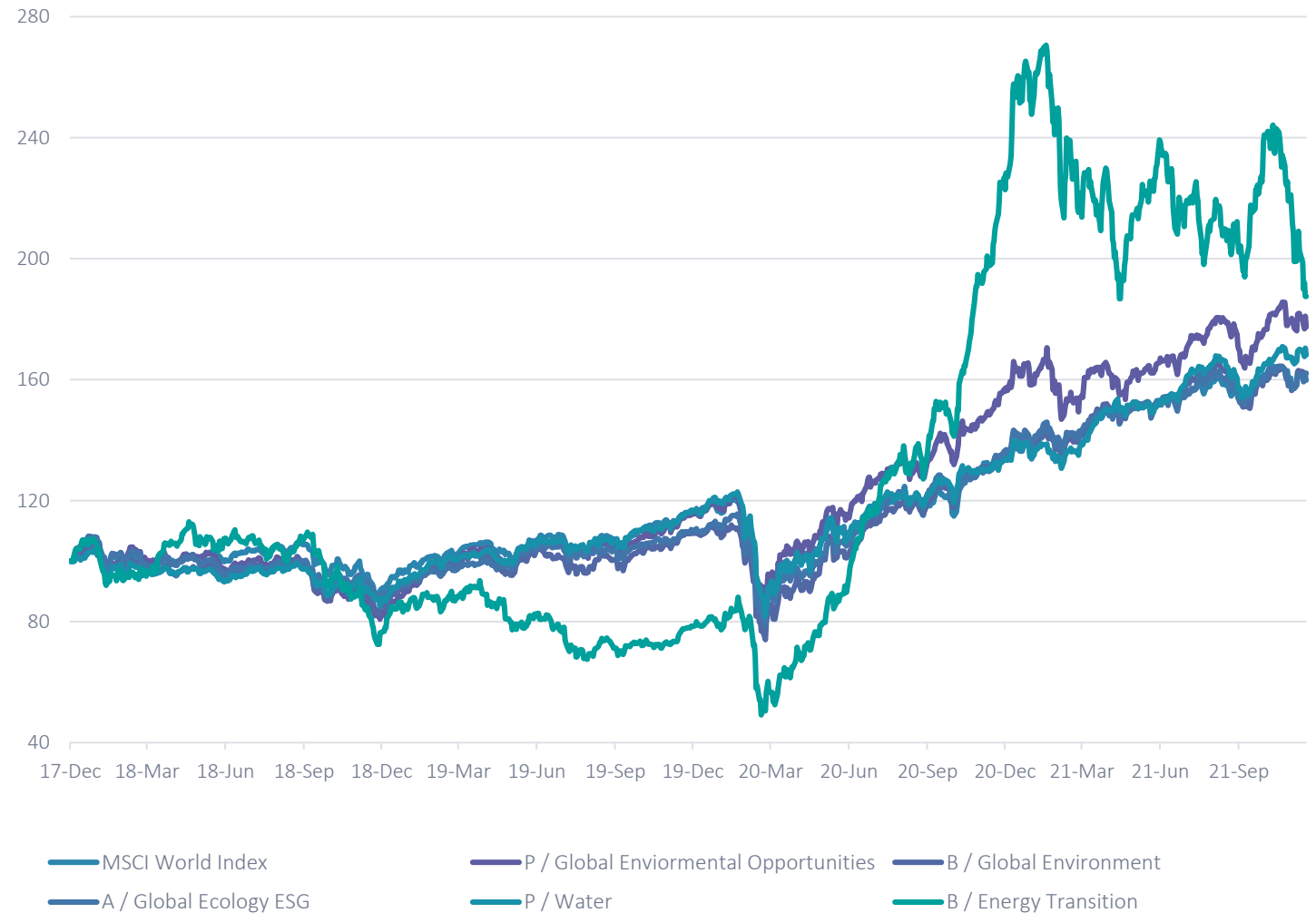
## US index with different ESG thematic



Source: Bloomberg, 2015/12/31 as standardize index 100  
NIC consolidated

# Article 9 funds comparison

- Article 9 funds should have most distinguished stock selection process considering ESG/Sustainability
- In fact, Article 9 funds are not necessary to derived from traditional funds, it depends on product design or manager style. (aggressive or conservative)
- Water fund could perform like global equity fund and Energy transition perform like single stock rather than a fund



Source: Bloomberg, 2017/12/31 as standardize index 100  
All Taiwan registered funds, NIC consolidated

# Sustainable stock samples

- Ørsted A/S

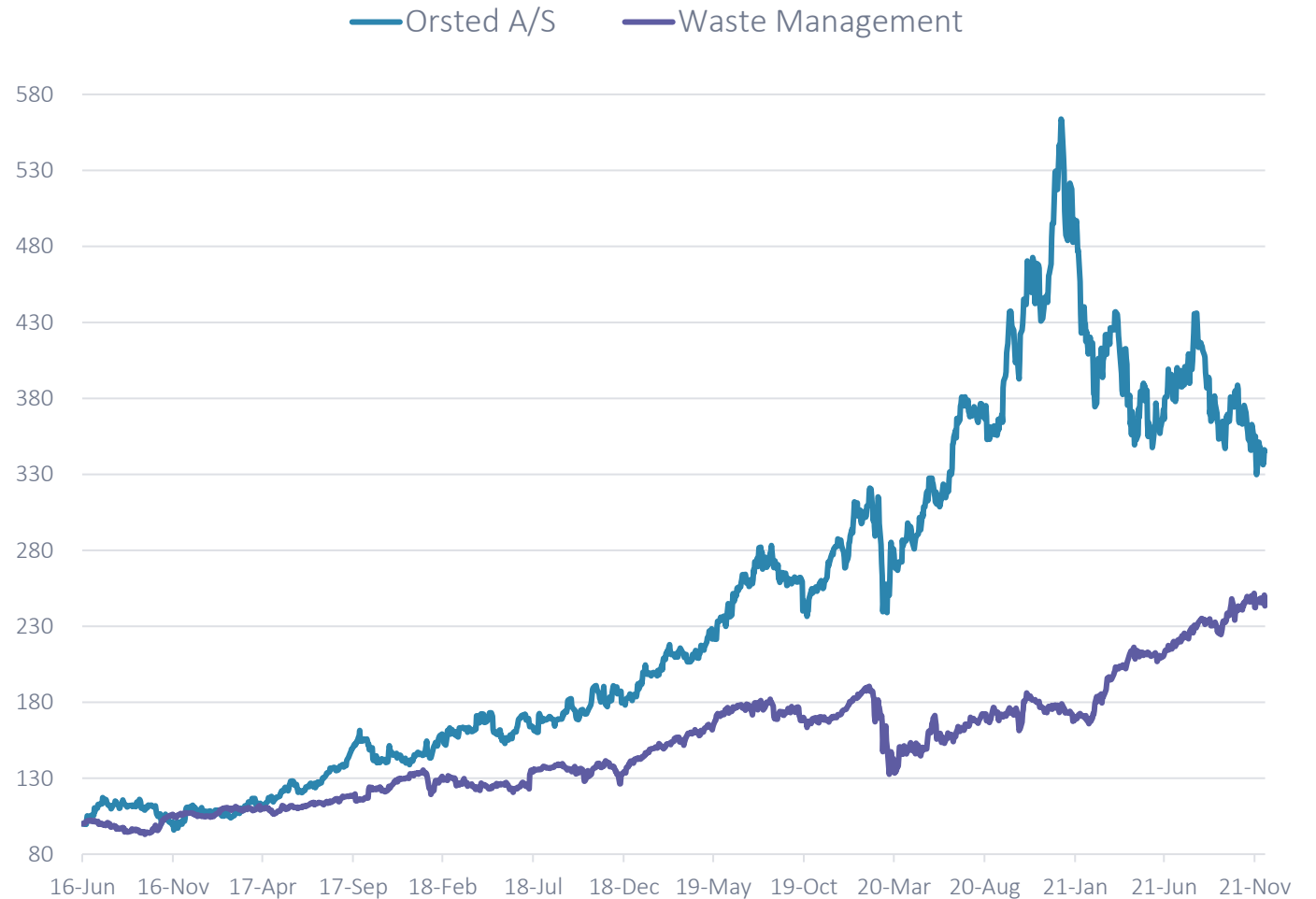
Provides utility services. The Company engages in the development, construction, and operation of offshore wind farms, as well as generates power and heat from power stations. Ørsted serves customers worldwide.

Market Cap : \$540Bn

- Waste Management

provides waste management services including collection, transfer, recycling, resource recovery, and disposal services, and operates waste-to-energy facilities. The Company serves municipal, commercial, industrial, and residential customers throughout North America.

Market Cap : \$670Bn



Source: Bloomberg, 2016/6/30 as standardize index 100

Reference to specific company does not constitute any investment recommendation

# Show me the alpha

- The natural source of alpha is always sector and stock selection
- So the alpha of ESG would only come with sectors and stocks benefited by sustainable trends
- Renewable energy, EV and water are high conviction sectors, but not guarantee as positive alpha forever
- Industrial, small/mid cap with many opportunities
- Mind overlay factors





## Simple questionnaire when considering invest ESG fund

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- Do your fund have any ESG rating ?
- What article do your fund apply to under SFDR ?
- Which external ESG data providers do you use ?
- Do you have in-house ESG scoring system ? Please elaborate step by step (better show screen snapshot)
- Do you have independent ESG team ? How do them co-work with your investment team ?
- How to classify ESG theme in portfolio ? What if controversy happen ? Take examples not invest due to ESG issue.





# Conclusion



- Sustainable trends obviously, but lots of asset flow to index
- Do choose article 9 fund to make sure cover same as context
- Shouldn't think of how to make marvelous money through sustainability
- Think of how to make better return among sustainability up to you have to
- Stocks would be re-rated if markets all agree its sustainability (story)

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