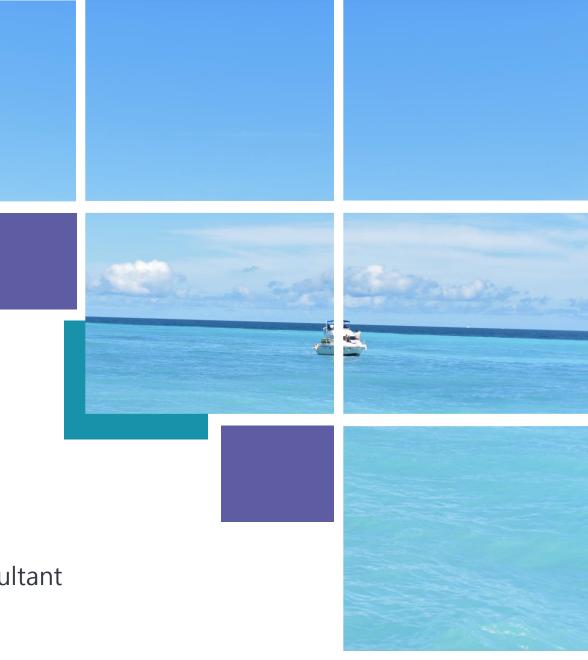
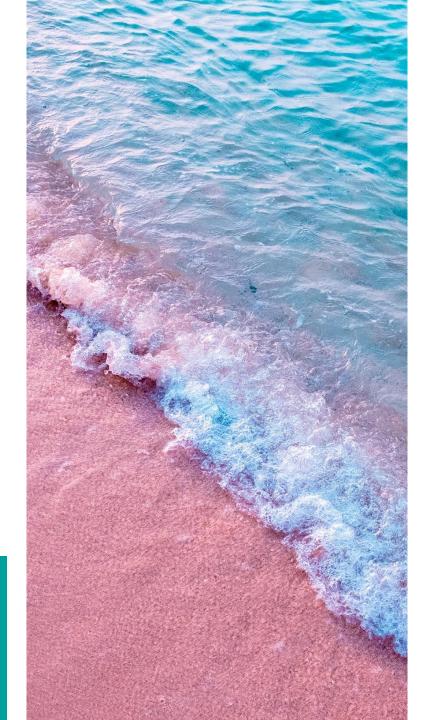
### Sustainable investment really sustainable ?

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

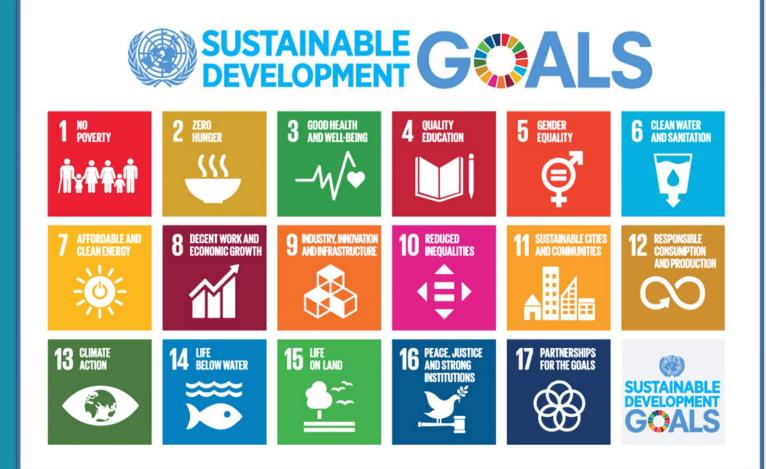
- Principles for Responsible Investment (UNPRI or PRI) is a United Nationssupported international network of investors working together to implement its six aspirational principles, often referenced as "the Principles"
- Earliest back to 2005, and then got supported by UN. Became the most influenced 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:

### **PR** Principles for Responsible Investment

### **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



#### **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)



#### **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 Parisaligned Benchmark.

Make real positive impact with clear objective while constructing portfolio.



#### **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



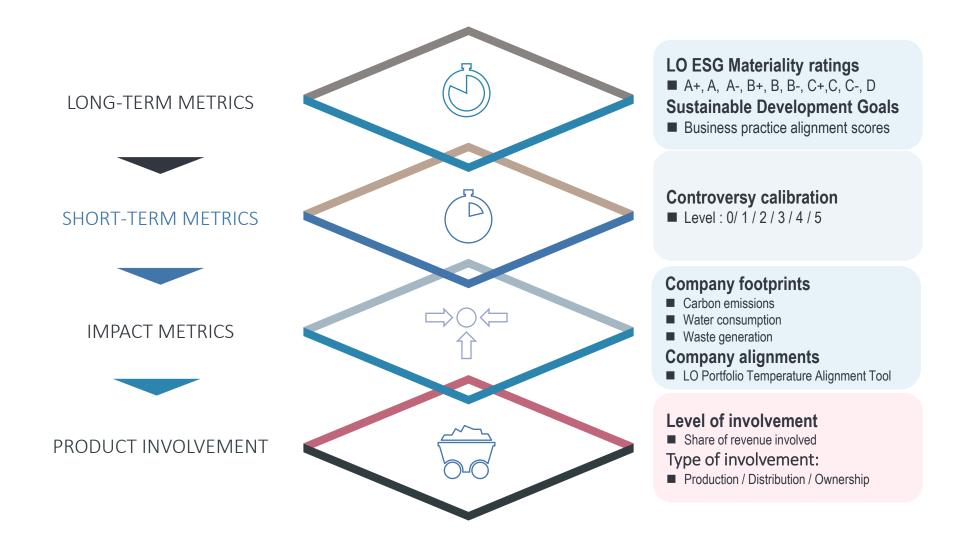
# ESG investment process sample

### Traditional ESG frameworks do not reflect what really matters

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

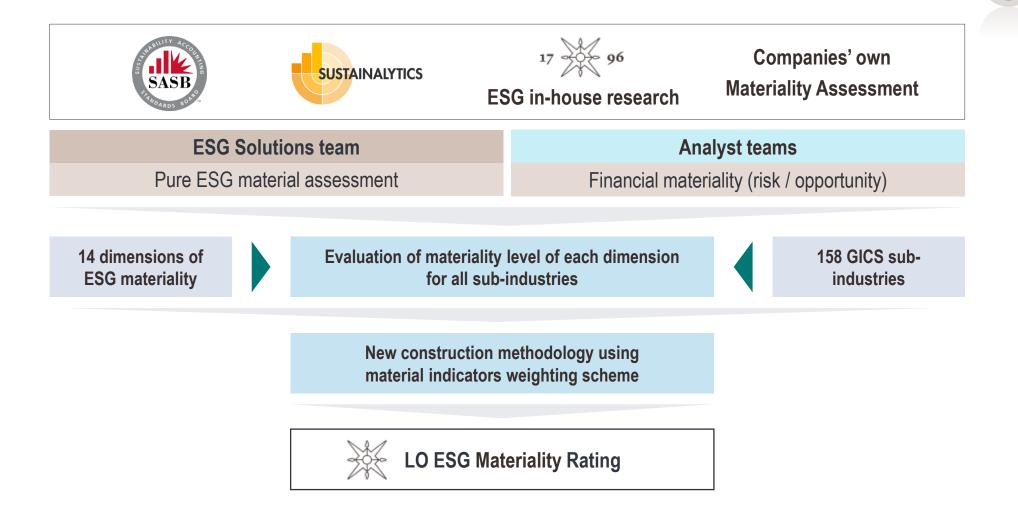


# Assessing the how: business practices Four-layered approach to ESG analysis



### How construct the LO ESG Materiality framework

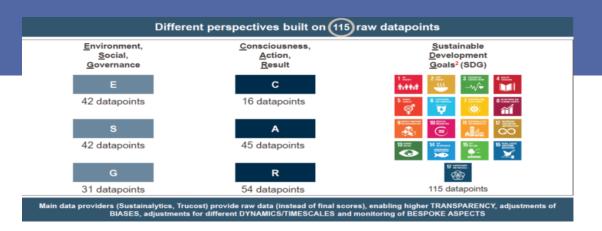
Materiality assessment methodology



# LO ESG Materiality Heatmap The material dimensions mapped across 158 GICS Level 4 sub-industries

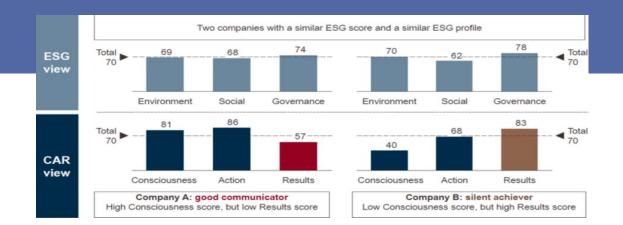
						Key	: Slight	ly material	Mildly r	naterial	Material	High	ly material
GICS name	Energy	Chemicals	Metals & mining	Transport & Infra	Automobiles	Consume Services	Retailing	Health Care	Pharma	Banks	IT Hardware	Renewable Electricity	Real Estate
Business ethics													
Corporate governance													
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

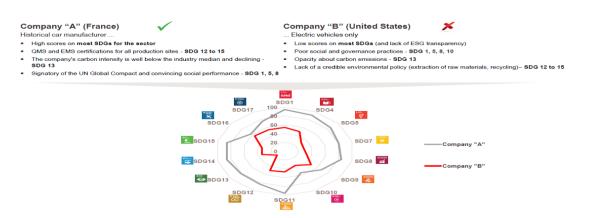


#### Use data provider raw data to build up in-house model

	E	S	G
<b>'C'</b> Consciousness	<ul><li>Environmental policy</li><li>Green procurement policy</li><li>Policy statement on GMO*</li></ul>	<ul><li>Discrimination policy</li><li>Responsible marketing policy</li><li>Human right policy</li></ul>	<ul><li>Bribery &amp; corruption policy</li><li>Political involvement policy</li><li>Money laundering policy</li></ul>
<b>'A'</b> Action	Greenhouse gas reduction, air protection or water management programmes     Environmental management system     Biodiversity programmes	<ul><li>Community involvement programme</li><li>Supply chain monitoring system</li><li>Diversity programme</li></ul>	Whistleblower programme     Signatory to the UN Global Compact     Independence of board and key     committee members
<b>'R'</b> Results	Carbon emissions / water consumption intensity     Environmental fines or non- monetary sanctions     Share of renewable energy used	<ul> <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><li>ESG committee with executives members</li><li>Gender diversity on the board</li><li>Independence of auditors</li></ul>
			= 115 data points

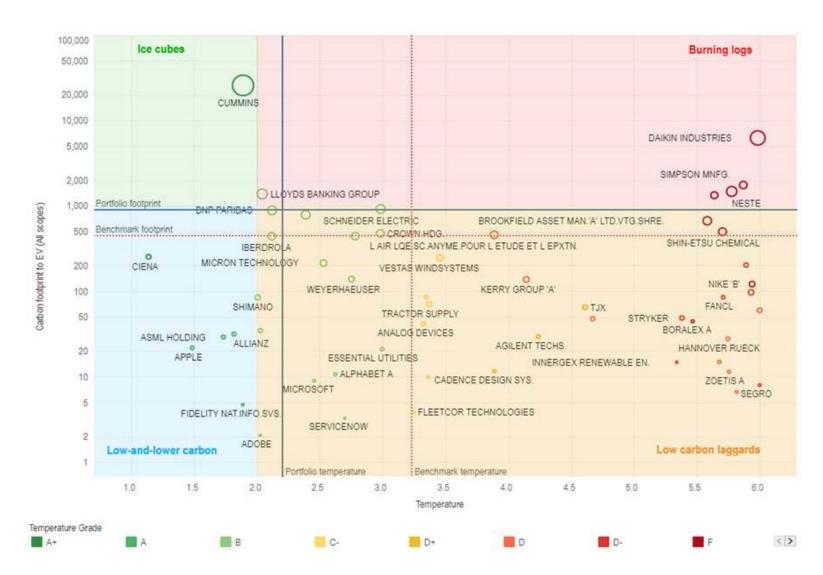


#### Investment comparison from different angle



### LO Portfolio Temperature Alignment Tool (LOPTA)

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

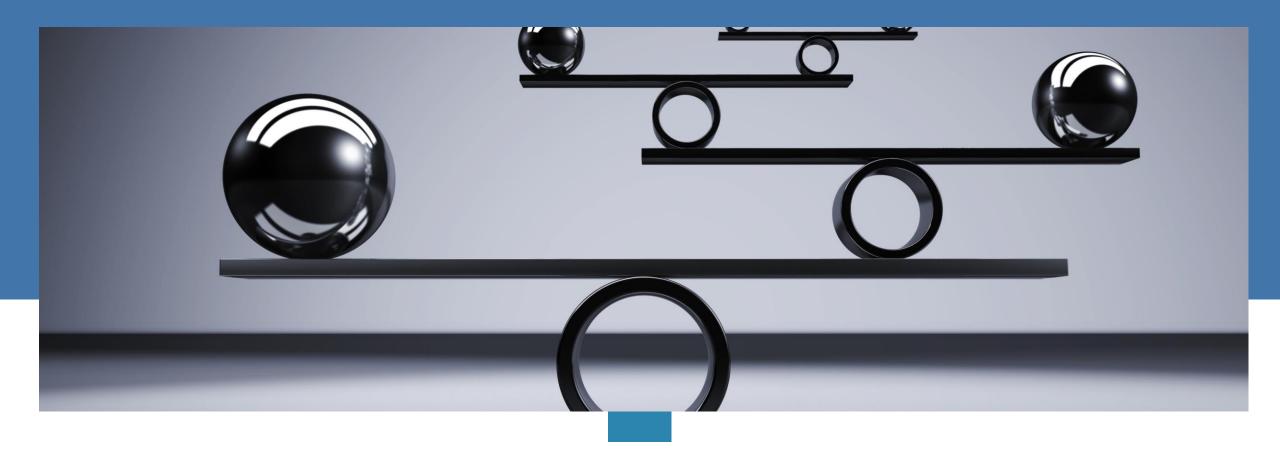


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	Country GICS 1 Sector	SWITZERLAND Health Care		2020-03-02	2020-03-02	0.0%	2020-03-02	2020-03-02
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#### Internal ESG-CAR scoring output

#### Integrated ESG Materiality rating and research platform

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# 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



#### How to reach data

Some ESG score publish on Bloomberg or market data system

Subscribe database to get complete content



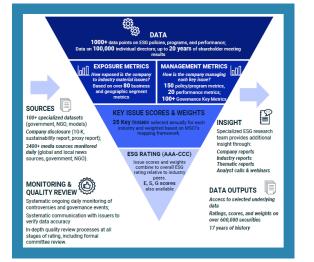
Methodology of company / fund / index

Data set ? Final ESG score



## MSCI ESG rating methodology

Turning score to letter rating



3 Pillars	10 Themes	35 ESG Key Issues				
Environment	Climate Change	Carbon Emissions Product Carbon Footprint	Financing Environmental Impact Climate Change Vulnerabili			
	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 Developmen Supply Chain Labor Standards			
	Product Liability	Product Safety & Quality Chemical Safety Financial Product Safety	Privacy & Data Security Responsible Investment 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				

Pillar Score Calculation	GOVERNANCE PILLAR SCORE (10 - Σ Deductions)									
		1	ì		1	}				
Theme Calculation	C	Corporate Gov (10 - Σ De	Corporate Behavior Score (10 - Σ Deductions)							
Key Issue Score Deduction	Ownership Score Deductions	Board Score Deductions	Pay Score Deductions	Accounting Score Deductions	Business Ethics Score Deductions	Tax Score Deductions				
	$\hat{\mathbf{U}}$	Û	$\hat{\mathbf{U}}$	Ŷ	$\hat{\mathbf{U}}$	Ŷ				
Key Metric Calculation	Ownership Key Metrics	Board Key Metrics	Pay Key Metrics	Accounting Key Metrics	Business Ethics Key Metrics	Tax Key Metrics				
	$\hat{\mathbf{U}}$	Ŷ	$\hat{\mathbf{U}}$	$\hat{\mathbf{U}}$	$\hat{\mathbf{U}}$	Ŷ				
Input Data	Ownership Data	Board Data	Pay Data	Accounting Data	Business Ethics Data	Tax Data				

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
В	Laggard	1.429 - 2.857
CCC	Laggard	0.0 - 1.429

Exposure and Management Metrics

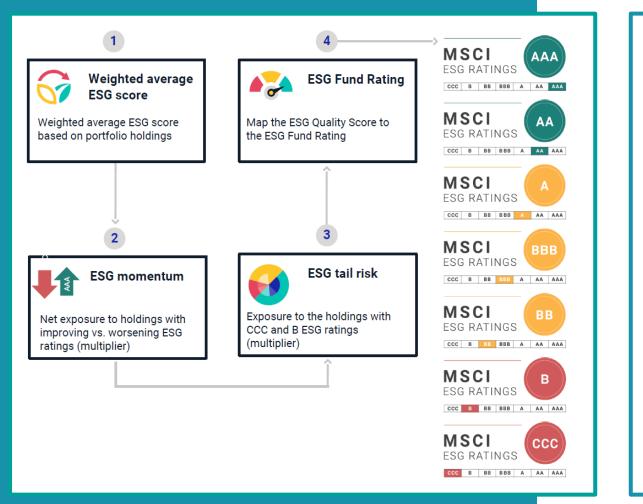
#### ESG Key Issue Hierarchy

#### Governance Model Structure

### Company Score is mapped to a Letter

#### MSCI ESG Fund Rating Methodology

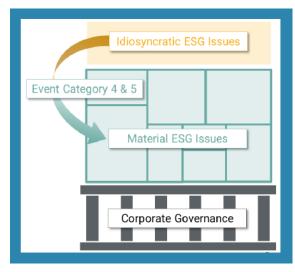


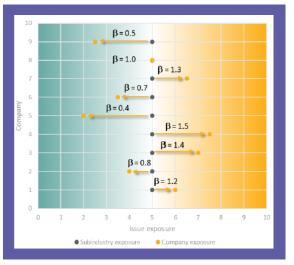


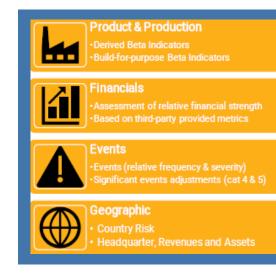


Source: MSCI ESG Research

#### Sustainalytics ESG scoring methodology Use unmanaged risk as final score (higher number, poor ESG)







Company Exposure	=	Subindustry Exposure	×	Issue Beta		
	=	8	*	1.5	=	12
Manageable Risk	=	Company Exposure	*	MRF		
	=	12	*	90%	=	10.
Managed Risk	=	Manageable Risk	*	Management score (as %)		
	=	10.8	*	75%	=	8.1
Unmanaged Risk	-	Company Exposure	•	Managed Risk		
	=	12		8.1	=	3.9

Three building blocks of ESG Risk Ratings Using beta concept to assess companyspecific exposure

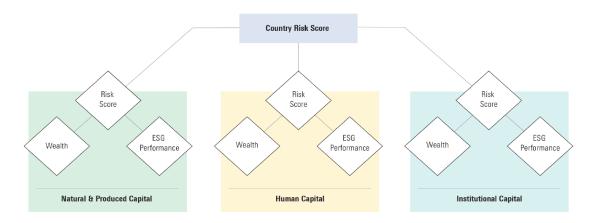
### Model for calculating issue betas

ESG Risk Ratings – the scoring structure

### Morningstar sustainability rating for funds methodology



#### ESG risk ratings for company and country risk ratings

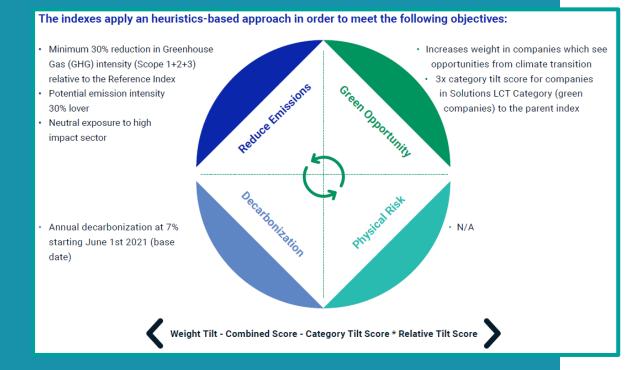


#### Combining corp and sovereign ratings in whole portfolio

Corporate Sustainability Rating	Corporate Contribution %	Sovereign Sustainability Rating	Sovereign Contribution %	Mornin Sustain	gstar ability Rating	
4	50	2	50	3		
4	80	2	20	4	Combined Corporate and Sovereign Rating	Rating lcon
4	20	2	80	2	>=4.5	
					<4.5 AND >=3.5	
					<3.5 AND >=2.5	
					<2.5 AND >=1.5	
					<1.5	0

#### MSCI Climate Change Indexes Methodology

#### MSCI Climate Paris Aligned Indexes Methodology





# **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



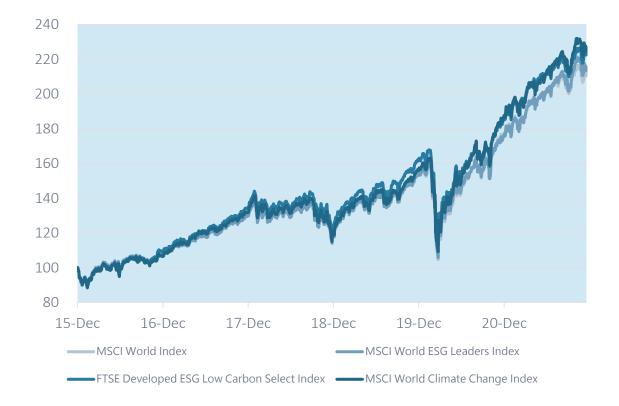


# How to find alpha through ESG

### 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

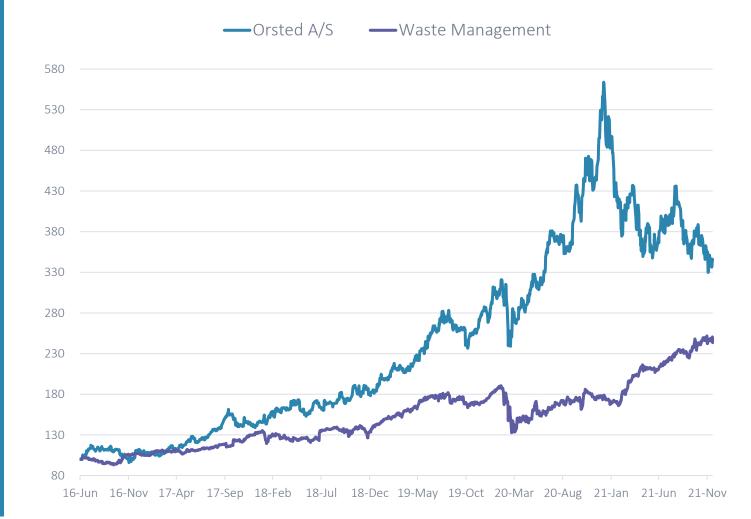
Provides utility services. The Company engages in the development, construction, and operation of offshore wind farms, as well as generates power and heat from power stations. Orsted serves customers worldwide.

Market Cap: \$540Bn

#### Waste Management

provides waste management services including collection, transfer, recycling, resource recovery, and disposal services, and operates waste-toenergy 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









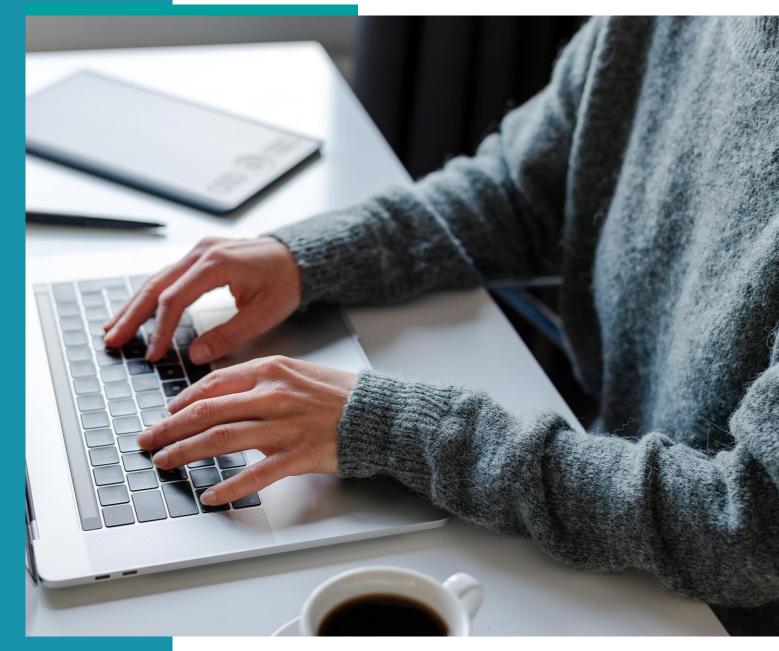




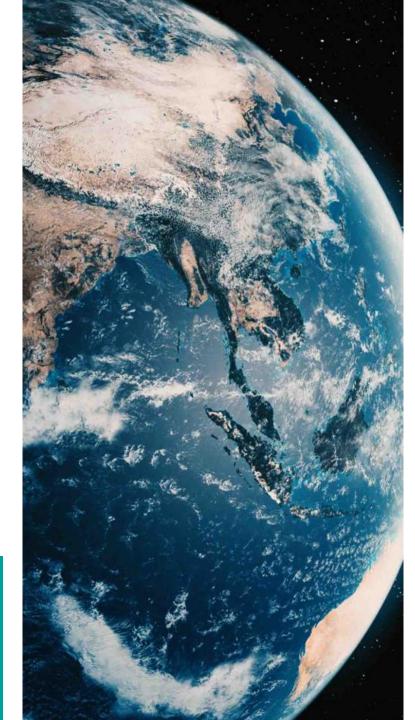


# Simple questionnaire when considering invest ESG fund

- 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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