Manulife Investment Management

ESG investing in Asia—an invisible evolution

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Introduction

Most discussions about climate change and sustainable investing within a global context will invariably note that Asia has a lot of catching up to do. It's a perspective that's difficult to dispute: The region has the dubious honour of being the world's largest emitter of greenhouse gases, accounting for more than 47.0% of global carbon emissions.[1] It also doesn't help that its global share of investment funds that abide by environmental, social, and governance (ESG) principles was a paltry 0.8% at the end of June 2020 (excluding Japan).[2] While few would argue with those observations, the full picture is much more nuanced.

In our view, a quiet evolution is taking place in Asia, albeit one that's largely escaped investor attention. The region's growth trajectory has been well documented; three out of five of the world's biggest economies in 2050 are expected to be Asian.[3] But that also underscores the scale of the challenges confronting the continent. The region's appetite for resources is understandable given the pace at which it's expanding—this, unfortunately, can also have the effect of making sustainability initiatives taken at the local level seem insignificant. As such, it isn't always easy to get an accurate read of the sustainability picture in Asia, a challenge that's undoubtedly compounded by the diverse, multifaceted nature of its economies, each of which is at a different stage of the development cycle, facing different sustainability issues.

Despite these challenges, awareness of ESG issues in the region is growing and important foundations have been laid. Given our intimate knowledge of the continent, having been in the region for more than a century, we would argue that the sustainability of business in Asia is increasingly important to investors as well as regulators, and the will to tackle these issues is strengthening. Crucially, we believe the growing sustainability drive could unlock compelling investment opportunities for fixed-income investors.

In this paper, we seek to outline how ESG investing has evolved in recent years, particularly in Asia. We also take a look at how the COVID-19 outbreak may have influenced investor attitudes toward sustainable investing and the role that Asia's policymakers play in the broader movement. Finally, we focus on the challenges that continue to hamper developments and highlight issues that investors should consider before deciding to allocate to Asia's growing sustainable investments market.

World's five biggest economies in 2050

1 China **2** India **3** United States **4** Indonesia **5** Brazil

Source: "The World in 2050," PWC, February 2017. Based on projected GDP according to purchasing power parity.

Charting the growth of sustainable investing in Asia

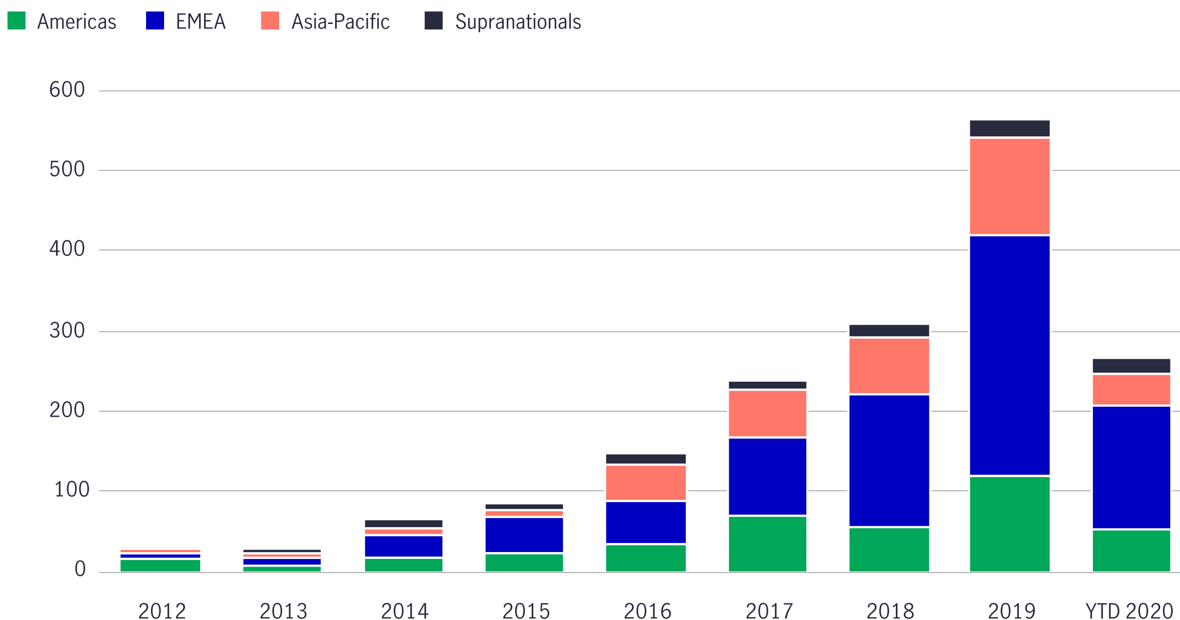
Market interest in sustainable investment is growing. According to Morningstar, assets under management in ESG funds globally rose above the US$1 trillion mark for the first time in June this year.[3] This underscores two important developments: rising investor appetite, which is matched by a growing willingness among bond issuers—both sovereign and corporate—to dip their toes into the sustainable debt market.

A recent report from credit ratings agency Moody's suggests that global sustainable debt issuance could reach US$375 billion in 2020, a rise of more than US$50 billion when compared with the previous year.[4] Although Asia accounts for only a small portion of the market, we expect that to change in the near future, judging by the pace of growth that we've seen in recent years.

The growth in Asia's sustainable debt market, which includes green, social, and sustainability bonds, has been remarkable. Before 2016, very few green bonds were issued in China, but by 2019, the country accounted for 12% of global green bond issuance.[5] As of August 2020, green, social, and sustainability bonds in Asia ex-Japan represented an outstanding amount of US$45 billion within the J.P. Morgan Asia Credit Index (JACI).[6]

The growth in issuance is driven by numerous factors—most notably by the rising awareness of climate change-related risks, recent and anticipated regulatory changes, and a growing recognition among issuers across the Asia-Pacific region of the need to diversify their sources of financing. In early 2020, it looked as if the coronavirus outbreak would temper both investors' and issuers' enthusiasm toward sustainability investing, an observation that made sense since the health crisis diverted everyone's attention. However, things took an unexpected turn.

Sustainable debt issuance per region (US$ billion)



Source: Bloomberg New Energy Finance, Sustainable Finance Market Outlook data set, as of June 30, 2020.

How COVID-19 has influenced the ESG investing movement

Given that it'll be some time before the dust settles, it may be premature to try and decipher how COVID-19 has affected ESG investing overall and, more specifically, in Asia. However, there have been developments that could, in hindsight, be deemed significant.

At the end of Q1 2020, when it became clear that the outbreak would have a much bigger—and lasting—impact on the global economy than first thought, there were concerns that interest in ESG investing would wane as attention and resources were diverted toward saving lives and preventing an economic depression from materialising. But once global markets stabilised, calmed by swift policy actions from central banks and a concerted—if unplanned—decision to ramp up fiscal spending globally, investors worldwide injected more than US$70 billion into ESG funds in the second quarter of the year.[7]

The suggestion here is that investors drew a direct connection between the coronavirus outbreak and sustainability issues. This could be partly due to the abundance of literature outlining how rising temperatures and poor standards of sanitation might have contributed to the spread of diseases such as COVID-19, thereby turning the spotlight back on to sustainability issues. It's also likely that the market swings that we experienced in March and April reminded investors of the importance of investing in securities that are backed by issuers with sustainable business models.

"While the pandemic seems to have temporarily tempered enthusiasm towards green bonds, investor interest in social bonds spiked, particularly in Asia."

In our view, the outbreak prompted investors to reassess sustainability risks, a subject that they've been increasingly aware of in the past few years. Market performance in the first seven months of the year supports this perspective from a risk-adjusted standpoint when looking at Asian credit markets, for instance. Through July, the J.P. Morgan ESG Asia Credit Index delivered a year-to-date return of 1.30% with 4.0% volatility, while the non-ESG version of the index delivered 1.14% but with a higher volatility of 4.3%.[8]

China green bond issuance
(RMB)

Year	Issuance
2016	**154.3B**
2017	**248.6B**
2018	**282.6B**
2019	**386.2B**

Source: Climate Bonds Initiative, as of June 2020.

The health crisis also brought about a separate, but related, development—the rise of social bonds.[9] While the pandemic seems to have temporarily tempered enthusiasm toward green bonds, investor interest in social bonds spiked, particularly in Asia. In the first seven months of 2020, US$17.6 billion in social bonds (some of which are aimed at mitigating the negative effects of the pandemic) were issued in Asia, up from US$3.6 billion a year ago.[10] Analysts are expecting the social bonds segment to continue to grow, and it's easy to see why this might be the case in the current environment.

While these developments suggest that the health crisis had brought us to an important inflection point in ESG investing and could well hasten its growth, we believe the reality is likely to be slightly more complicated than that.

The surge in fiscal spending, itself a response to containing the economic fallout from the COVID-19 outbreak, implies that the competition for attention and resources from investors as well as policymakers is set to become more intense.

In such an environment, it's sensible to assume that governments will be inclined to focus more on supporting healthcare systems and saving jobs, thereby relegating the task of addressing ESG issues as a secondary priority.

There are also fears that regulators would roll back existing environmental policies as part of their bid to revive growth—these concerns are valid because it's already taken place in the United States[11] and India,[12] among others.

However, it's important to note that many policymakers have chosen to pair their respective recovery plans with broader sustainability goals and incorporated relevant ESG projects into their stimulus programmes. While that's no doubt an encouraging development, it remains unclear if policymakers will be able to strike a sensible balance between both sets of goals. Although these goals aren't necessarily mutually exclusive, and investments into sustainability projects can also create jobs and contribute to growth, resource limitation remains a constraint. To an extent, the choices that governments ultimately make will likely depend on when a vaccine for COVID-19 can be widely available. Until then, it'll be difficult to assess how the virus outbreak has affected ESG investing. However, we expect ESG bond issuance to continue to rise, driven by policy needs as well as growing investor interest, thereby broadening the opportunity set available within the segment.

Social bond issuance in Asia

(USD)

2019	**$3.6B**
2020	**$17.6B**

Source: BNN Bloomberg, as of August 13, 2020. The figure listed for 2020 represents social bonds issued in the first seven months of the year.

We expect ESG bond issuance to continue to rise, driven by policy needs as well as growing investor interest, thereby broadening the opportunity set available within the segment.

Investment case for Asia within the context of ESG

It's fair to say that most investors are more than familiar with the main arguments outlining Asia's appeal. The gradual broadening of growth that began with China now includes parts of southern Asia, which is home to billions who are expected to join the ranks of the middle class in the coming decades; however, it also faces considerable challenges from an environmental and sustainability perspective. The region's population is ageing rapidly,[13] and rising sea levels pose a huge risk to its coastal megacities even as water scarcity is set to become a bigger issue in the coming decades.[14]

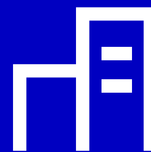
Most, if not all, initiatives aimed at addressing sustainability issues will require substantial funding, particularly those pertaining to climate change (e.g., the construction of new infrastructure, updating new facilities). In view of the nature of these projects, it's logical to assume that the public sector will be heavily involved—in Asia, especially—and that debt financing will be a natural fit.

From a fixed-income perspective, there are three sustainability themes that we believe to be most relevant to Asia: climate change, corporate governance, and, finally, the continent's ageing population.

Key sustainability themes in Asia

1 **Climate change**

2 **Corporate governance**



3 **Ageing population**

1 Climate change

That Asia is a global driver of climate change isn't news; neither is the expectation that the region will be most affected by its adverse effects. But rather than framing it as an insurmountable challenge, it could be more helpful to focus on the potential solutions.

• Reducing greenhouse gas emissions

Given that Asia is one of the world's biggest emitters of greenhouse gases, the notion that it's also one of the biggest investors in clean technology/renewable energy might seem counterintuitive. In truth, however, the region's policymakers have very good reasons to want to do so—to mitigate the expected environmental impact of climate change, which is itself an expectation of the continent's increasingly wealthy and sophisticated population. The region's leaders are therefore incentivised to pursue a gradual transition to renewable energy and invest in improving energy efficiency as well as storage capacity. Related initiatives could also include widening the availability of public transportation, the development of energy-efficient buildings, and the introduction of a national/regional carbon emissions trading scheme. Needless to say, these initiatives will require funding from investors.

• Water scarcity

The disconnect between Asia's water needs and the region's lack of water resources is well documented—the continent has 33% of the world's available fresh water, but is home to 60% of the world's population.[15] Research suggests that by 2050, water scarcity could affect up to 3.4 billion of the region's population, potentially threatening food security.[16] Once again, technological innovation and investment can play an important role in the search for solutions. In addition to improving existing infrastructure, investment into research and development could also uncover ways to improving water-usage efficiency, particularly among traditionally water-intensive industries.

Asia's water scarcity problem

60%

of the world's population

33%

of the world's fresh water

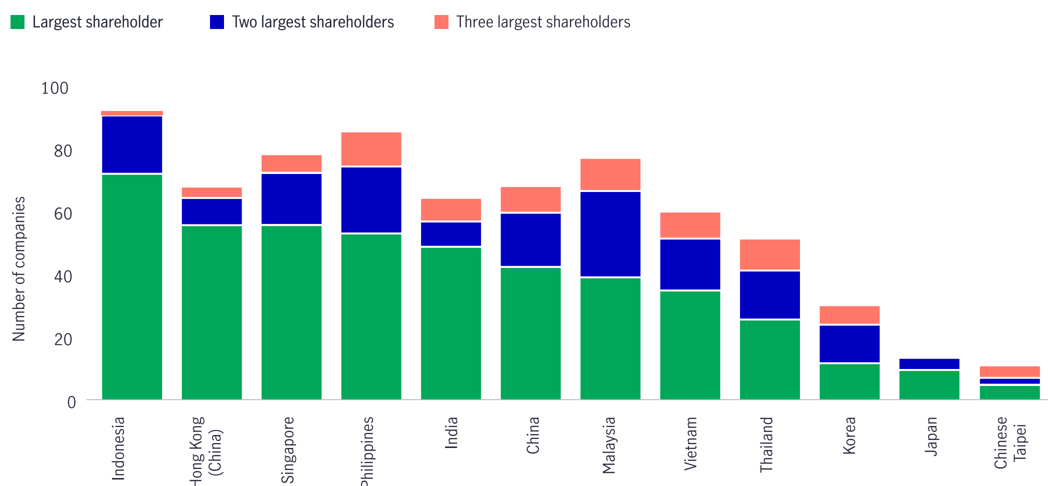
2 Corporate governance

Transparency, fairness, and accountability—these form the bedrock of good corporate governance, ensuring that companies are well run and deploying investor capital effectively. In recent years, its scope has broadened to include achieving equality, diversity, and sustainability goals. However, governance standards can vary significantly in Asia, which typically features in the lower tier of most global corporate governance rankings.

The statistics tell a compelling story: Most large Asian companies are often owned by a few shareholders, a trait they share with many smaller or nonlisted corporate bond issuers in the region, making potential conflicts of interest a particularly relevant issue. Separately, although gender diversity is improving across businesses in Asia, female representation on corporate boards continues to trail behind the global average. In Asia, women held only 9.3% of board seats in 2018, versus 16.9% worldwide.[17]

We believe this is an area in which policymakers and investors can make a real difference. Regulators in the region are increasing requirements for corporate disclosure; for instance, the separation of CEO and chairman roles are now mandatory for listed companies in India, Bangladesh, Mongolia, Pakistan, and Vietnam. The practice is also formally recommended in Australia, Hong Kong, Malaysia, New Zealand, Singapore, and Thailand. Investors, meanwhile, can actively engage with companies that they've invested in to encourage board independence, increased disclosure, and improved transparency. In other words, while the region does have a fair amount of catching up to do on this front, things are moving in the right direction.

Companies with controlling shareholders, as of the end of 2018



Source: Organisation for Economic Co-operation and Development, Equity Market Review Asia 2019, www.oecd.org/corporate/oecd-equity-market-review-asia.htm, November 27, 2019. The figure shows the number of companies (out of the largest 100 listed companies in each market) in which the single largest, two largest, and three largest shareholders hold at least 50% of the capital.

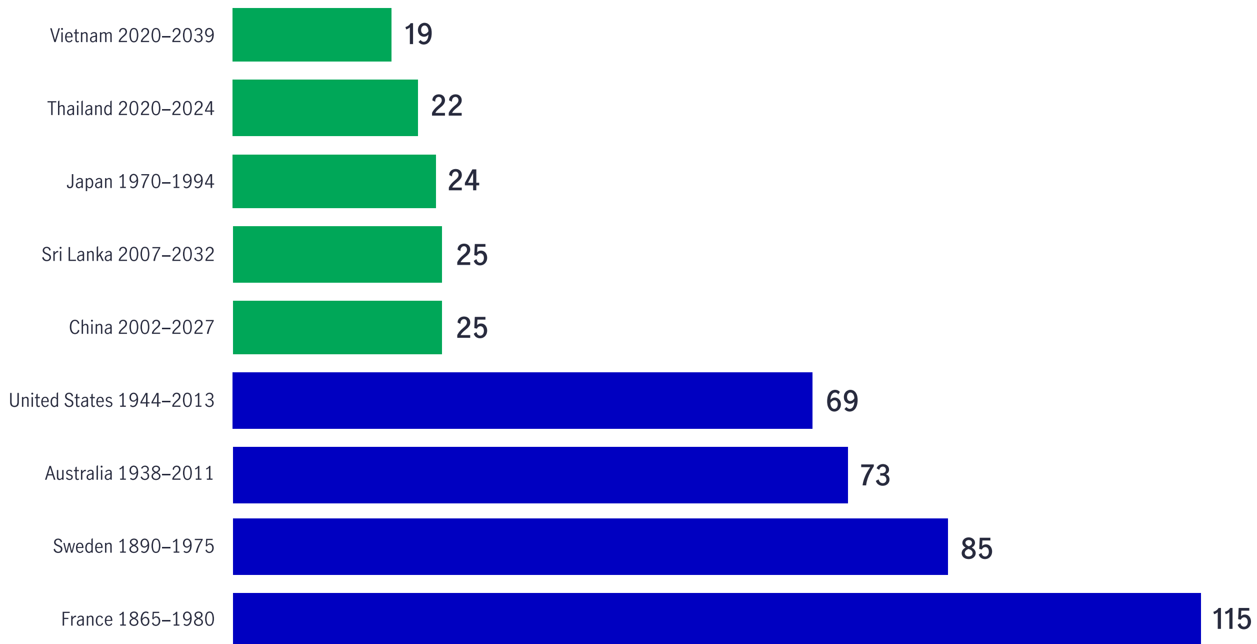
3 Asia's ageing population

Improving life expectancy and declining birth rates are part of the economic development cycle—as the region's economies grow, it's only natural that it'll begin to experience demographic transition. What's uniquely challenging for Asia, however, is the pace at which the transition is occurring, which is three to four times faster than most developed nations,[18] meaning that what typically occurs over a century in other countries is taking place within a single generation in Asia. The economic tailwind of being home to a growing working population has reached an inflection point and is slowly becoming a headwind.

In our view, many of Asia's economies aren't fully prepared for the rapid ageing of its population that's set to occur over the next two decades. It's a development that's likely to pose challenges to the region's pension systems, where coverage remains low but savings withdrawal (before official retirement age) remains common. Once again, investment and research into technology that can improve the quality of life of the elderly becomes increasingly important. While the region's financial and wealth management industry has come up with innovative products in recent years that could help to mitigate the issue, more work is needed. Regulators should engage with the private sector to ensure that the society will be equipped to tend to their ageing population, whether it's through reforming their respective healthcare or pension systems.

"The economic tailwind of being home to a growing working population has reached an inflection point and is slowly becoming a headwind.

The time taken in years to move from an ageing to aged society



Source: United Nations Economic and Social Commission for Asia and the Pacific Ageing in Asia and the Paciic, 2016.

The role of Asia's policymakers

Sustainability issues are highly complex by nature and often take a long time to resolve. Although the private sector's involvement could influence the pace at which these issues are addressed, it isn't always possible for them to come up with solutions on their own.

For any initiative to be meaningful, stakeholders with competing interests need to come together and work toward a sensible solution. More often than not, these endeavours require significant coordination, a firm commitment, and a fair amount of resources.

For these reasons, policymakers are often best placed to take the lead—this is particularly true in instances in which the issue at hand crosses national boundaries, such as tackling air pollution originating from a neighbouring country or territory. In such a scenario, it would make sense for national governments to take the lead and bring everyone to the table. From what we can see, it's an approach that seems to be working very well in Asia.

- **Central banks**

The region's central banks are extremely supportive of developing green financing and could well be engaging in an unspoken race to the top to outdo each other. A survey of 18 Asian central banks showed that all but 2 agree that climate risk has become an important area of focus for them, and 17 believe that they have an important role to play to encourage carbon financing initiatives.[19]

The People's Bank of China, for instance, introduced a number of significant measures in recent years that could have an important impact on sustainability financing; in 2018, it began accepting green bonds as collateral for its medium-term lending facility programme[20] and will soon begin assessing banks on a quarterly basis to see if they're doing enough to support green financing.[21]

Singapore, meanwhile, has never made a secret of its intention to be a leading centre for green finance in the region; the Monetary Authority of Singapore recently launched a US$2 billion investment programme to support the initiative.[22] Separately, the Hong Kong Monetary Authority[23] and Bank Negara Malaysia[24] have joined forces with their respective securities commission to assess how the financial industry should respond to climate risks. While it could be some time before these initiatives bear fruit, they serve as important signposts of where things are heading.

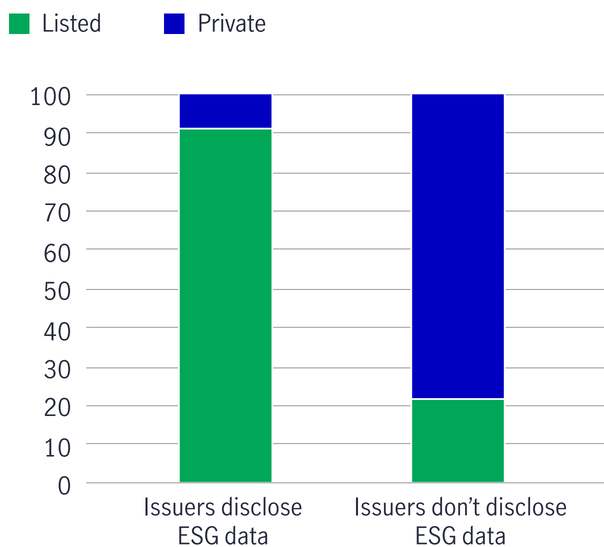
“The region’s central banks are extremely supportive of developing green financing and could well be engaging in an unspoken race to the top to outdo each other.”

- **Stock exchanges**

There's also a growing recognition among the region's stock exchanges of the impact that material ESG factors can have on the long-term prospect of a listed firm. Many of them have taken steps to requiring/encouraging listed firms to provide relevant ESG information. This is perhaps also a reflection of investor demands—many are increasingly taking the view that an investment screening process isn't complete unless ESG factors/sustainability factors have been included.

Two markets stand out in particular—China and Thailand. The Shanghai Stock Exchange and the Shenzhen Stock Exchange published their social responsibility guidelines in 2008 and 2006, respectively, well ahead of most of their global peers.[25] Most notably, China Securities Regulatory Commission announced that it would make ESG disclosures mandatory for all listed firms and bond issuers by 2020.[26]

Listed companies have better ESG disclosures (%)



Source: Bloomberg, company data, HSBC, September 2020. No ESG data is available on Bloomberg.

Separately, Thailand's reputation as a regional leader on the ESG reporting front might also surprise some—the Stock Exchange of Thailand has consistently featured strongly in Corporate Knight's annual ranking of global exchanges, which is based on the quality of ESG disclosures. It also has the honour of being the only exchange from the Asia-Pacific region to feature in the top 10 since 2018. It's not an insignificant achievement, considering the London Stock Exchange came in at 15 and the New York Stock Exchange was placed at 40.[27]

In our view, the region's stock exchanges' embrace of ESG disclosures is key to the growth of sustainable investing. It's a crucial component to what can be best described as a virtuous cycle in the push to encourage listed firms to provide meaningful ESG data to investors, a development that can enhance awareness and arm investors with better-quality information to make better investment decisions.

- **Sovereign wealth funds**

The region's sovereign wealth funds have also been ramping up efforts to address sustainability issues—it's another means through which the region's governments can effect positive change and create momentum. Singapore's Temasek Holdings, for instance, has committed to produce a report detailing the organisation's usage of water, paper, electricity, and air miles and has set a target to halve the greenhouse emissions of its portfolio by 2030.[28] Meanwhile, South Korea's Korea Investment Corporation has made responsible investing and sustainability a central pillar of its strategy, aptly named Sustainable Growth Vision 2035.[29] Similarly, Thailand's Government Pension Fund has committed to stepping up its emphasis on ESG themes in its investment screening process and avoiding firms that fail to meet its standards.[30]

We think it's clear that the region's policymakers have made important progress toward addressing sustainability issues—even if their efforts aren't likely to lead to results that are immediately obvious, important foundations are being laid.

Case study

Opportunities within Asia's sustainability space—renewable energy

Asia's growth potential has been well documented. One often quoted report suggests that by 2050, three out of five of the world's biggest economies will be Asian: China, India, and Indonesia.[3] It's an observation that illustrates succinctly the almost unstoppable momentum behind the region's growth. However, that pace of growth—and the associated rise in demand for relevant resources—cannot be maintained if sustainability issues aren't addressed. This has provided the region's policymakers with the incentive to tackle these issues head on, paving the way for Asia's prominence in the global renewable energy market.

According to a recent report, Asia-Pacific is the fastest growing market for renewable energy globally, accounting for nearly 27% of the market.[31] This is particularly true in the solar energy segment, where more than half of cumulative installed energy capacity is in Asia.[32] China and India are widely recognized as world leaders in this area, each vying to be the global leader in this space.

China is expected to invest as much as US$6 trillion into the development of new energy technology by the end of the decade[33] and has dominated the world's solar panel market, manufacturing more than 70% of the world's supply in 2017.[34] Similarly, China has a commanding presence in the global lithium ion battery market, which is vital to electric vehicles; it produced more than 60.0% of the world's lithium ion batteries in 2018.[35] Although sales of electric vehicles in China have suffered in the wake of the COVID-19 outbreak, the country still remains the world's biggest market for such vehicles.[36]

The narrative in India isn't too different: When the Indian government made renewable energy a central part of its growth strategy and put in place policies that were supportive of its goal, the industry blossomed. Between 2014 and 2019, India's renewable energy industry grew by 17.5% a year, raising the country's share of renewables in its energy mix to 10.0% from 6.0%.[37] In January this year, India's President Ram Nath Kovind reiterated the country's goal of hitting 450 gigawatts of green energy capacity by the end of the decade.[38] The government has also thrown its weight behind the electric vehicles industry and is looking into setting up integrated batteries and cell manufacturing giga plants with the help of the private sector.[39]

Asia's push toward sustainability is fuelled as much by growth as it is by necessity, which we believe will lead to compelling opportunities. We believe this to be particularly true for fixed-income investors, given that many of these initiatives will require substantial funding support from the private sector.

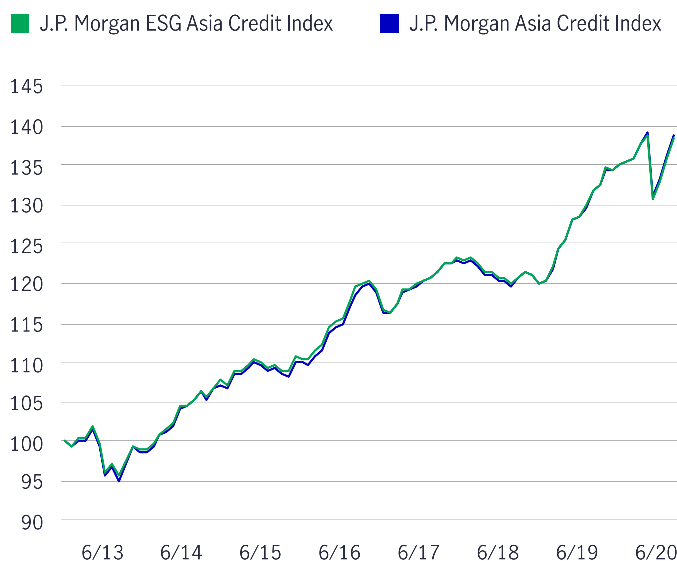
Tracking performance: should investors worry about the sustainability performance trade-off?

Is it possible to do well from doing good, or should investors expect to take some form of a discount on the performance front when switching to sustainable investing? According to research conducted by the International Monetary Fund (IMF), the answer appears to be no—IMF analysis suggests that the performance of sustainable and conventional funds is comparable.[40] The fund's analysis is broadly consistent with the market performance of Asian fixed income; for instance, the cumulative risk-adjusted return for the J.P. Morgan ESG Asia Credit Index from December 2012 to August 2020 is almost on par with the JACI, with only 28 basis points between them.[41]

However, the difference in terms of the impact that the constituents of each respective index has on the environment is drastic. From a carbon intensity perspective, JACI's constituents emit nearly 491 tonnes of carbon dioxide (CO_2) for every US$1 million of sales generated. In contrast, constituents of the J.P. Morgan ESG Asia Credit Index emit only 166.4 tonnes of CO_2 per US$1 million of sales.[42] Although the difference in terms of performance is minute, the disparity between the two from a sustainability perspective couldn't be more striking. In our view, the disparity between the two will likely resonate with investors who are concerned about sustainability. More importantly, impending changes to regulation, coupled with growing investor demand for sustainable solutions, are likely to change relative performance drivers going forward.

Tracking differences in performance

Cumulative performance, from December 2012–August 2020



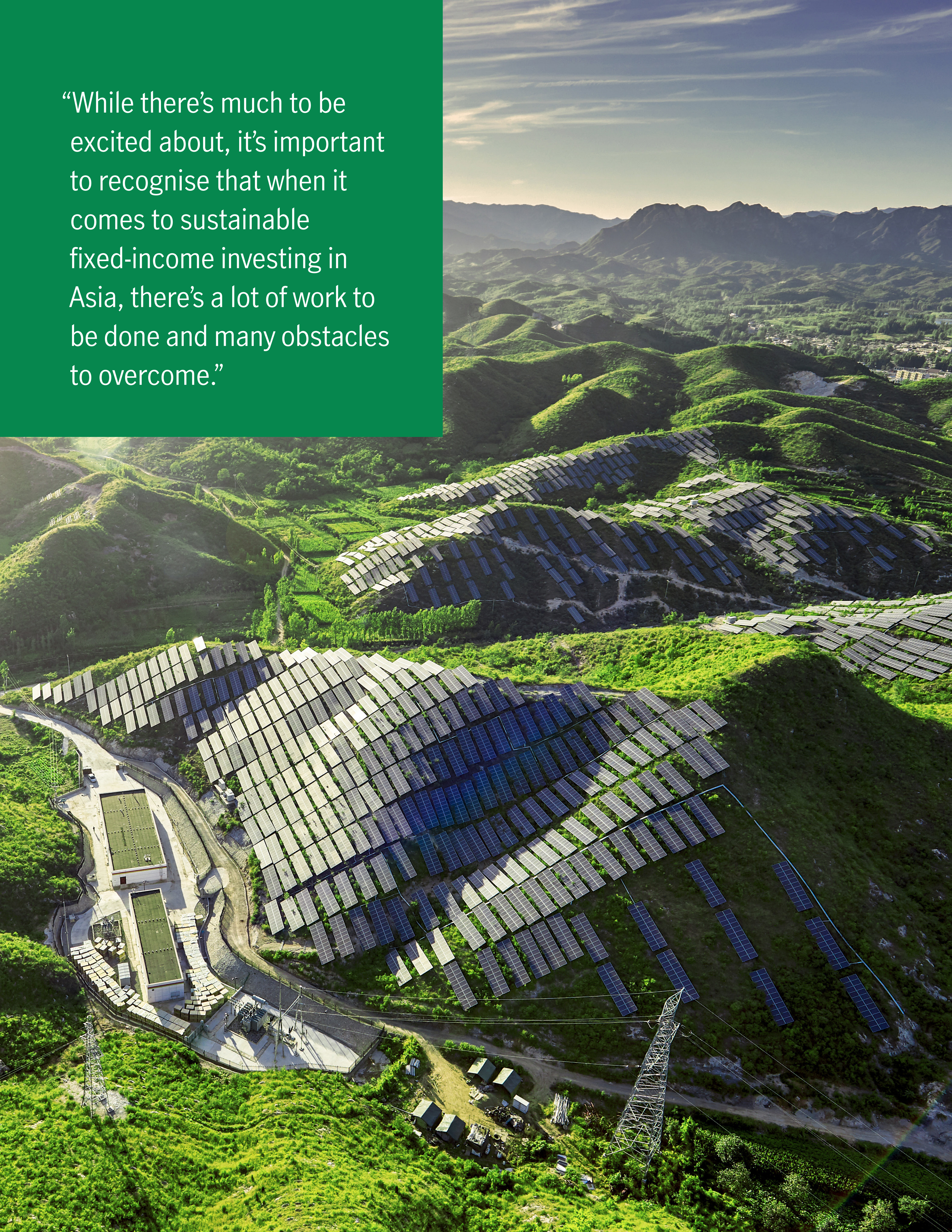
Source: Bloomberg, MSCI, August 31, 2020. Figures shown are in gross USD terms. It is not possible to invest directly in an index. Past performance does not guarantee future results.

Returns (%)

J.P. Morgan ESG Asia Credit Index	**41.63**
J.P. Morgan Asia Credit Index	41.95
Difference	– 0.32

Carbon intensity (tonnes CO_2E/ US$M sales)

J.P. Morgan ESG Asia Credit Index	**166.4**
J.P. Morgan Asia Credit Index	490.9
Difference	324.5



"While there's much to be excited about, it's important to recognise that when it comes to sustainable fixed-income investing in Asia, there's a lot of work to be done and many obstacles to overcome."

Key challenges: taxonomy, quality, and governance

While there's much to be excited about, it's important to recognise that when it comes to sustainable fixed-income investing in Asia, there's a lot of work to be done and many obstacles to overcome.

The absence of a common taxonomy has often been cited as a reason efforts in the development of sustainable investing have been hindered. Data vendors, ESG research providers, issuers, and investors can have varying criteria and terminology that can create an obstacle for the industry. This can become a headache for issuers who might be thinking of tapping into the green bond market. The lack of a common standard can mean having to procure different metrics for different groups of investors, which can nudge costs higher.

One other issue that policymakers will need to address in this area relates to ratings: ESG-scoring firms aren't regulated in the same way that regular credit ratings firms are. This raises important questions that go beyond the simple—but no less important—matter of quality. A significant portion of green bonds coming onto the debt market often go through an external review process in order to procure the relevant green label. Since these external reviewers aren't bound to a certain set of definitions, rules, or processes, it's given rise to concerns relating to greenwashing, where proceeds raised from the debt sale might be used in a way that might not be consistent with the issue's green categorisation.

From this perspective, the European Union's introduction of its very own classification system of sustainable activities in July 2020[43] couldn't be better timed. It's widely regarded as the world's first truly comprehensive, science-based classification system, and one that's likely to pave the way to a meaningful convergence of taxonomies and regulations going forward.

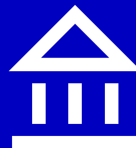
Key sustainability themes in Asia

Consistency

The lack of a globally used taxonomy poses problems for issuers and investors

Regulation

ESG-rating firms aren't regulated the same way as credit-rating companies



Labelling

Greenwashing: Funds raised may not be used in a way consistent with labelling

Investing in sustainable fixed income in Asia—important considerations

Asia's fixed-income markets are relatively fragmented—as long-term investors in the region, we've always taken pains to impress on investors the heterogenous nature of Asian economies. Each of the region's economies is structurally distinct, shaped by its own culture and its own unique experience of history. While we believe that the continent's diversity can often lead to compelling risk-adjusted opportunities that investors might struggle to find elsewhere within the fixed-income universe, investment success does require an intimate knowledge of the region, particularly in the sustainability space.

Most sustainability issues are geographically and culturally specific, meaning that local expertise in the form of local language skills and local knowledge is needed to help fill information gaps that can't be sourced from third-party ESG data providers. While this may suggest that investment managers with an extensive footprint in the region are more likely to do well, we believe presence alone isn't sufficient—a more relevant gauge would be the amount of resources that a manager has allocated to support the endeavour. We've listed some factors below that should be taken into consideration.

ESG integration and support

Fixed-income investment management and ESG research are two separate disciplines—integrating ESG factors into the fixed-income investment process requires a lot of work, as does postintegration monitoring. In other words, the amount of ESG resources that's available to the investment team can be critical: Does the fixed-income team have access to a dedicated team of ESG analysts at the local/regional level? How is the ESG team integrated into the research/screening process—does ESG credit screening sit at the heart of the investment process, or does it seem like an afterthought? Is it part of an established firmwide ESG framework accompanied by a comprehensive governance structure to ensure that key objectives are met? We believe these are important considerations that can make a material difference to investment outcomes.

- **Proprietary research capability**

The growth of sustainable investing has led to a surge in independent ESG data providers; however, gaps in coverage can often restrict the number of securities that investors can have access to. The shortage of external analyst coverage is a persistent issue within the Asia fixed-income universe—it should come as no surprise that the issue is exacerbated in the area of sustainable investing. In China, for example, there are more than 328 Chinese issuers in the JACI out of a total of 605 issuers.[44] While ESG ratings coverage for these firms is set to rise in tandem with growing demand from investors and changes in regulations, inconsistencies in approach between external ESG ratings providers can lead to additional confusion instead of providing clarity.

> We believe that active investors are more likely to do well in this space—without an active research team and a fully engaged investment team, passive investment vehicles aren't able to contextualise the specific nature of the region's sustainability challenges.

Having access to a local research team is also important for a different reason—not all ESG factors can be quantified (for instance, reputation and goodwill may be relevant but difficult to measure). Analysts on the ground can provide qualitive insight where relevant quantitative metrics don't exist. Crucially, they can help to contextualise and explain why different ESG-data vendors have vastly different views of the same issuer. In our view, a well-resourced local research team is a prerequisite to investment success in the Asian sustainable fixed-income space.

This is why we believe that active investors are more likely to do well than passive investors in this space. Without active, dedicated researchers and a fully engaged investment team, passive investment vehicles aren't able to contextualise the specific nature of the region's sustainability challenges. Even within the active space, we believe investment managers with the capability to produce proprietary localised ESG fixed-income research are more likely to have an edge over peers who rely on ESG analysis from global data vendors.

- **A holistic approach to ESG**

In our view, sustainable investing encompasses much more than generating returns through investing in companies that meet ESG criteria; it's also about using our position as institutional investors to influence debt issuers (corporates, sovereigns, and quasisovereigns) that we invest in to embrace sustainability best practices.

Investment managers who understand the significance of sustainability challenges are likely to have a comprehensive ESG framework that, in all likelihood, includes an engagement programme outlining how they intend to engage with issuers and policymakers to effect positive change. Bondholders may not have the same voting rights as equity shareholders, but they remain an important stakeholder to issuers, thereby creating an entry point that could facilitate important discussions. We believe the same can be said of sovereign and quasisovereign debt issuers.

A comprehensive engagement programme can also facilitate important conversations between various interest groups and policymakers, helping to shape relevant policies and providing additional expertise where needed.

Conclusion

Investor cynicism regarding Asia's sustainability efforts can often be traced back to its record of being one of the biggest contributors to greenhouse gas emissions globally and its less-than-stellar score on common governance metrics. However, the region's collective efforts speak for themselves—important foundations have been laid in the last few years that could have embedded the concept of sustainability into the continent's future. While there can be no doubt that more will need to be done, a meaningful sustainability movement has taken shape in Asia—one that we believe will translate into truly compelling opportunities for fixed-income investors.

It's encouraging to see that the region's policymakers made a point of incorporating sustainability goals into their broader stimulus programmes; it's a recognition that these initiatives can contribute to growth over the longer term. However, in the immediate term, where the task of arresting the economic fallout arising from the COVID-19 outbreak is likely to take top priority, policymakers might find themselves in the unenviable position of having to make difficult resource allocation decisions in the face of limited budgets. That said, we're confident that Asia's commitment to sustainability is genuine. In fact, we're of the view that the region has moved beyond the inflection point and we expect the positive momentum to continue to build.

We firmly believe that the investment industry has an important role to play in helping the region progress its sustainability agenda. Crucially, historical data shows that Asian fixed-income investors are able to significantly reduce their carbon footprints without needing to lower their expected level of returns, proving that investors who've done their homework can indeed be rewarded fairly while contributing to an important cause.

1 Global Carbon Atlas, December 2018. **2** Morningstar Research, as of June 2020. **3** "The World in 2050," PWC, February 2017. **4** "Sustainable bond issuance hits record high in Q2 as social bonds surge," Moody's Investors Service, August 17, 2020. **5** "China Green Bond Market 2019 Research Report," Climate Bonds Initiative, CCDC Research, HSBC, June 25, 2020. **6** J.P. Morgan Asia Credit Index, data as of August 31, 2020. We note that the ESG version of this index, the JESG JACI, which narrows the JACI investment universe by around a quarter based on ESG performance metrics, has delivered near-identical returns to the JACI since December 31, 2012, based on J.P. Morgan's backtesting: "Introducing the JESG JACI," November 27, 2019. **7** "ESG funds attract record inflows during crisis," *Financial Times*, August 10, 2020. **8** MSCI, as of July 31, 2020. The performance cited is in U.S. dollar terms. **9** Social bonds refer to debt securities where proceeds are used to finance or refinance social projects. **10** "Korea Overtakes China as Biggest Sustainable-Debt Seller in Asia," BNN Bloomberg, August 13, 2020. **11** "Trump Weakens Major Conservation Law to Speed Construction Permits," *New York Times*, July 15, 2020. **12** "EIA 2020 an assault on India's ecology: Congress," the *Hindu*, August 12, 2020. **13** "Asia's Ageing Challenge," The Economist Intelligence Unit, July 23, 2018. **14** "Is Asia facing a coming water crisis?" International Institute for Applied Systems Analysis, June 18, 2018. **15** "Solutions for a global water crisis," Citibank Research, April 2017. **16** "Are Asia's Pension Funds Ready for Climate Change?" China Water Risk, April 2019. **17** "Women in the boardroom: A global perspective," Deloitte, October 31, 2019. **18** "Ageing in Asia and the Pacific," United Nations Economic and Social Commission for Asia and the Pacific, March 8, 2017. **19** "Asia's Central Banks Must Rise to the Challenge of Climate Change," Economic Research for ASEAN and East Asia, March 17, 2020. **20** "Central Bank to Accept Lower-Grade Collateral for Lending Facility," Caixin Global, June 4, 2018. **21** "China plans quarterly looks into banks' green finance performance," *Business Times,* July 21, 2020. **22** "New US$2 billion Investments Programme to Support Growth of Green Finance in Singapore," Monetary Authority of Singapore, November 11, 2020. **23** "Joint statement on the establishment of the Green and Sustainable Finance Cross-Agency Steering Group," Hong Kong Monetary Authority, May 5, 2020. **24** "Inaugural Meeting of Joint Committee on Climate Change," Bank Negara Malaysia, September 27, 2019. **25** "ESG Disclosures in Asia Pacific," CFA Institute, July 21, 2019. **26** "China ramps up focus on socially responsible investments," cgtn.com, December 4, 2019. **27** "Corporate Knights report shows sustainability disclosure is flatlining: 'Time for regulators to step in,'" Corporate Knights, January 22, 2020. **28** "Temasek sets 2030 target for its portfolio to halve greenhouse emissions," November 13, 2019. **29** "KIC aims to manage $400 billion by 2035," *Korea Times*, July 1, 2020. **30** "Biggest Thai Pension Fund Buys Foreign Stocks to Boost Gains," BNN Bloomberg, August 23, 2020. **31** "Global Renewable Energy Market Value 2020," Expert Market Research, June 24, 2020. **32** "Snapshot of Global PV Markets 2020," International Energy Agency, April 29, 2020. **33** "Promoting China's Energy Transformation through Deepened Supply-side Structural Reform," Development Research Centre of the State Council of the People's Republic of China, August 21, 2020. **34** "Greener Pastures: China Cuts A Path To Becoming A Green Superpower," S&P Global Ratings, November 19, 2018. **35** "Electric cars: China powers the battery supply chain," *Financial Times*, May 22, 2019. **36** "China promises subsidies to boost falling electric car sales," ABC News, April 24, 2020. **37** "Why India is the new hotspot for renewable energy investors," World Economic Forum, January 14, 2020. **38** "India to have 450 GW renewable energy by 2030: President," *Economic Times*, January 31, 2020. **39** "Opportunities in EV battery and cell manufacturing in India," Invest India, July 2, 2020. **40** "Sustainable investors match the performance of regular investors, IMF research finds," cnbc.com, October 10, 2019. **41** Bloomberg, Manulife Investment Management, as of August 31, 2020. **42** MSCI ESG Manager, FactSet, August 2020. **43** "EU taxonomy for sustainable activities," European Commission, August 28, 2020. **44** J.P. Morgan Asia Credit Index, as of August 31, 2020.

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