

ESG

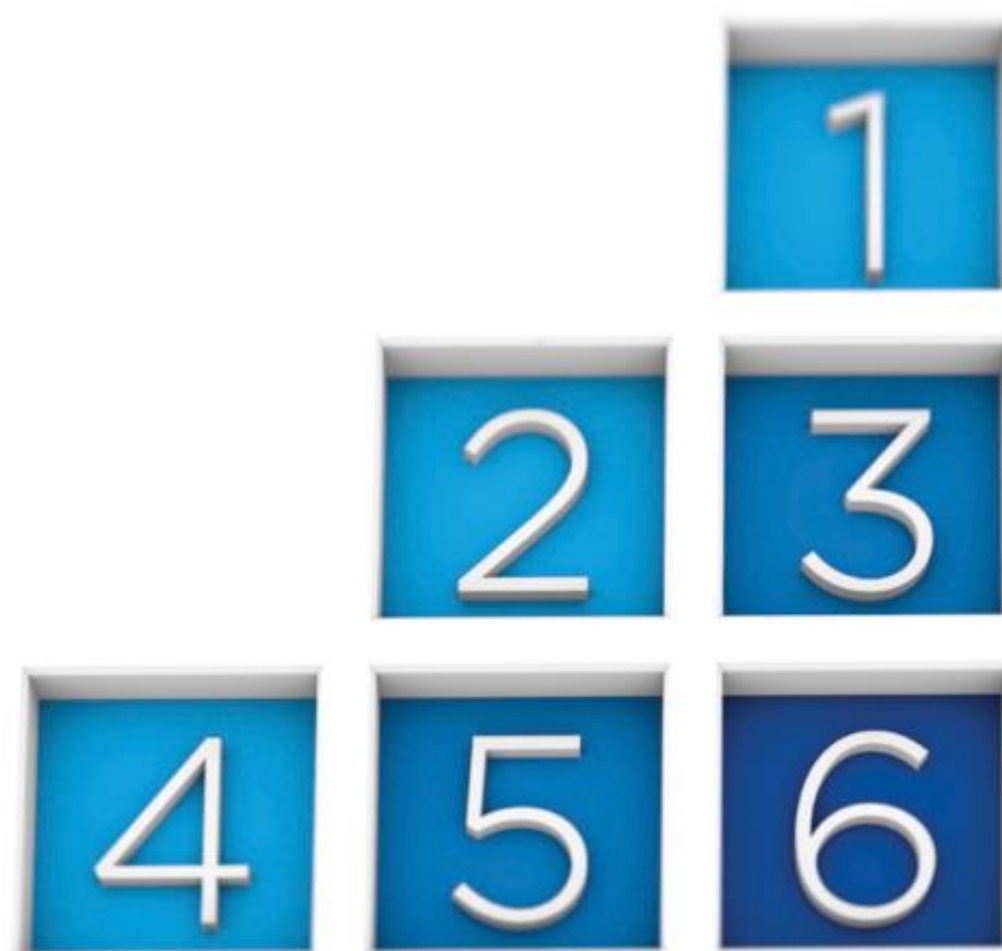
What is ESG?

- **E**nvironmental, **S**ocial, and **G**overnance
- represents the three main criteria for investors to quantify and evaluate a company's level of sustainability
- Environmental: a company's performance in protecting the environment
- Social: examine how it manages relationships with employees, suppliers, customers, and communities
- Governance: a company's leadership, executive pay, audits, internal controls, and shareholder rights

Where is ESG coming from?

- The term was first coined in 2004 in a UN research report, [Who Cares Wins](#)
- its importance was reaffirmed in 2006 by the UN ***Principles for Responsible Investment (PRI)*** – an international organization that works to promote the incorporation of ESG into investment decision-making
- The PRI has over 3000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US \$90 trillion in assets under management

- 1 We will incorporate ESG issues into investment analysis and decision-making processes.
- 2 We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4 We will promote acceptance and implementation of the Principles within the investment industry.
- 5 We will work together to enhance our effectiveness in implementing the Principles.
- 6 We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ESG Factors

E (Environmental)

Conservation of the natural world

- Climate change and carbon emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

S (Social)

Consideration of people and relationships

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labor standards

G (Governance)

Standards for running a company

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contribution
- Whistleblower schemes

Note: There is no one exhaustive list of ESG examples. ESG factors are often interlinked, and it can be challenging to classify an ESG issue as only an environmental, social, or governance issue, as the table below shows.

FIGURE 2: INSIGHT INVESTMENT'S ESG RATINGS FRAMEWORK

ESG Overall Score Normalized industry-adjusted score 1-5							
Environment Pillar Absolute score 1-5			Social Pillar Absolute score 1-5			Governance Pillar Absolute score 1-5	
Carbon	Natural Capital	Pollution	People	Products	Place	Corporate Governance	Behavior
Carbon emissions	Water stress	Toxic emissions	Labor management	Product safety and quality	Controversial sourcing	Board	Business ethics
Carbon vulnerability	Biodiversity and land use	Waste	Health and safety	Chemical safety		Pay	Anticompetitive practices
Product footprint	Raw material sourcing		Human capital development	Financial product safety		Ownership	Corruption and instability
Financing			Supply chain	Privacy and data security		Accounting	Financial system instability
			Health and demographic risk	Responsible investment			Tax transparency

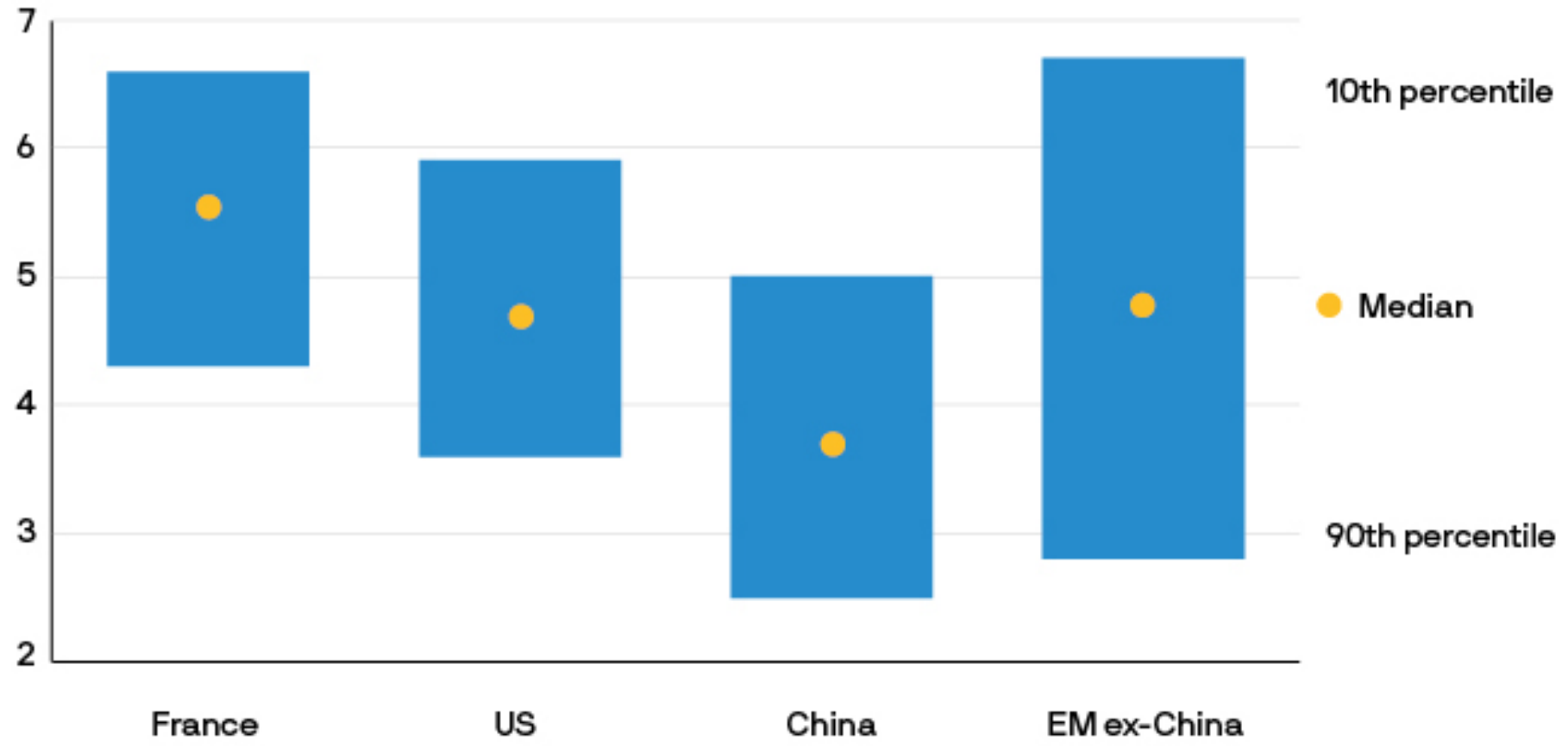
} Ratings used in Risk Checklist

} ESG issues

Assessed category for all issuers

Source: Insight Investment and MSCI Inc. For illustrative purposes only. Based on MSCI ESG ratings framework.

MSCI ESG score



Source: MSCI, J.P. Morgan Asset Management. The score represents the weighted average of the scores received by MSCI on all the key issues contributing to the final rating of the company. Data as of 11 May 2022.

<https://am.jpmorgan.com/lu/en/asset-management/per/insights/market-insights/market-updates/on-the-minds-of-investors/china-and-esg-investing/>

CUMULATIVE INDEX PERFORMANCE – GROSS RETURNS (USD)
(SEP 2007 – SEP 2022)



INDEX CHARACTERISTICS

	MSCI China ESG Leaders	MSCI China
Number of Constituents	164	721
Weight (%)		
Largest	23.45	11.80
Smallest	0.01	0.01
Average	0.61	0.14
Median	0.11	0.03

TOP 10 CONSTITUENTS

	Index Wt. (%)	Parent Index Wt. (%)	Sector
TENCENT HOLDINGS LI (CN)	23.45	11.80	Comm Svcs
ALIBABA GRP HLDG (HK)	16.67	8.39	Cons Discr
MEITUAN B	10.28	5.17	Cons Discr
CHINA CONSTRUCTION BK H	6.15	3.09	Financials
BAIDU (HK)	3.55	1.78	Comm Svcs
NETEASE	3.46	1.74	Comm Svcs
WUXI BIOLOGICS	2.39	1.20	Health Care
BYD CO H	2.26	1.13	Cons Discr
YUM CHINA HOLDINGS	2.21	1.11	Cons Discr
CHINA MERCHANTS BANK H	2.01	1.01	Financials
Total	72.43	36.43	

Challenge of ESG in China

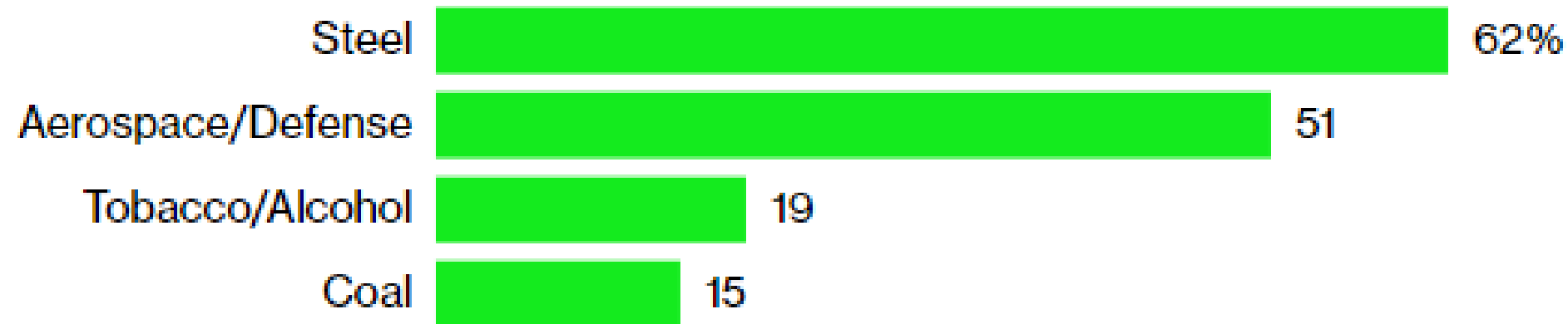
(especially before June 2022)

- Had no unified ESG information disclosure standard
- No integrated ESG legal documents, only some relevant laws and regulations mainly focused on environmental protection and social responsibility
- What fits for the west may not fit for China, (local) investors also seem to care about different issues
 - A local analyst would consider being a state-owned enterprise a good thing, while their counterpart in Europe might consider it a deal-breaker
 - China's ESG funds may prioritize firms that contribute to energy security or rural jobs programs alongside more typical sustainable holdings

ESG With Chinese Characteristics

Of more than 170 ESG funds in China, many invest in steel, defense, alcohol and tobacco

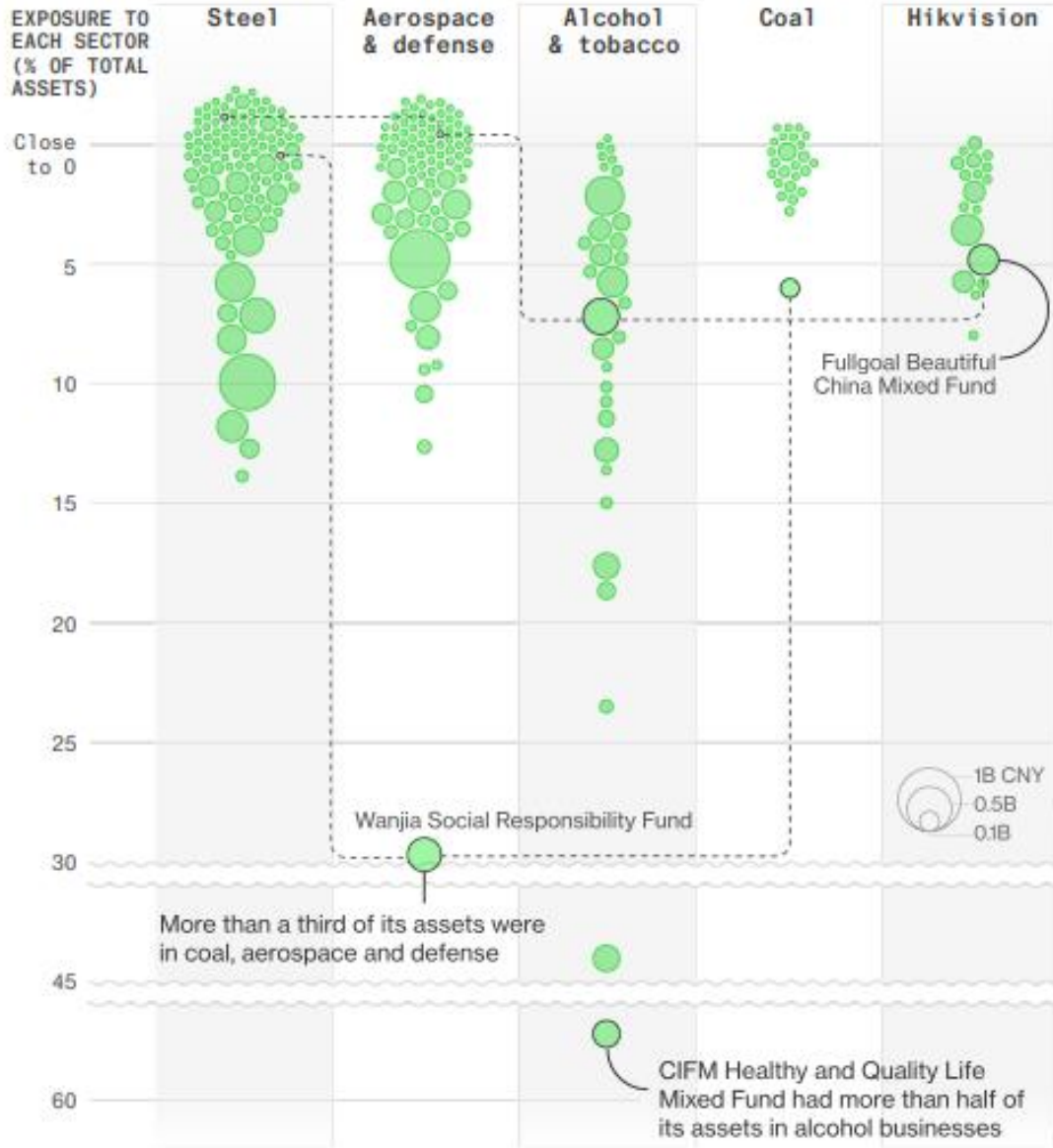
■ Percentage of funds with exposure to sector



Source: Bloomberg

Notes: Data as of June 2022; funds with unknown asset values are excluded.

Each circle represents an ESG fund in China with holdings in these areas, sized by value of investments there



Source: Bloomberg

Notes: Data as of June 2022; CIFM data from Dec 2021; Hangzhou Hikvision Digital Technology Co., a Chinese surveillance tech firm, is under US trade sanctions.

Seemingly difference.....

- ESG funds domiciled in Europe held about \$130 billion in Chinese assets — more than twice the size of China's own domestic ESG fund industry
- US-managed funds own close to \$8 billion in Chinese holdings.
- Funds look to mimic government's priorities
 - emissions cuts for cleaner air and water
 - income inequality
 - social mobility

Successful fund managers need localization of ESG

Results of the PRI'S investor survey on ESG disclosure in China

- Lack of reliable and comparable ESG data remains the biggest barrier for sustainable investment in China
- difficulty to receive meaningful response on ESG issues when engaging with Chinese companies
- corporate investor relations departments having limited knowledge of their company's ESG information and performance
- difficulty finding the right department/person to communicate on ESG matters.
- 98% of respondents believe it is important to align with international frameworks and metrics.

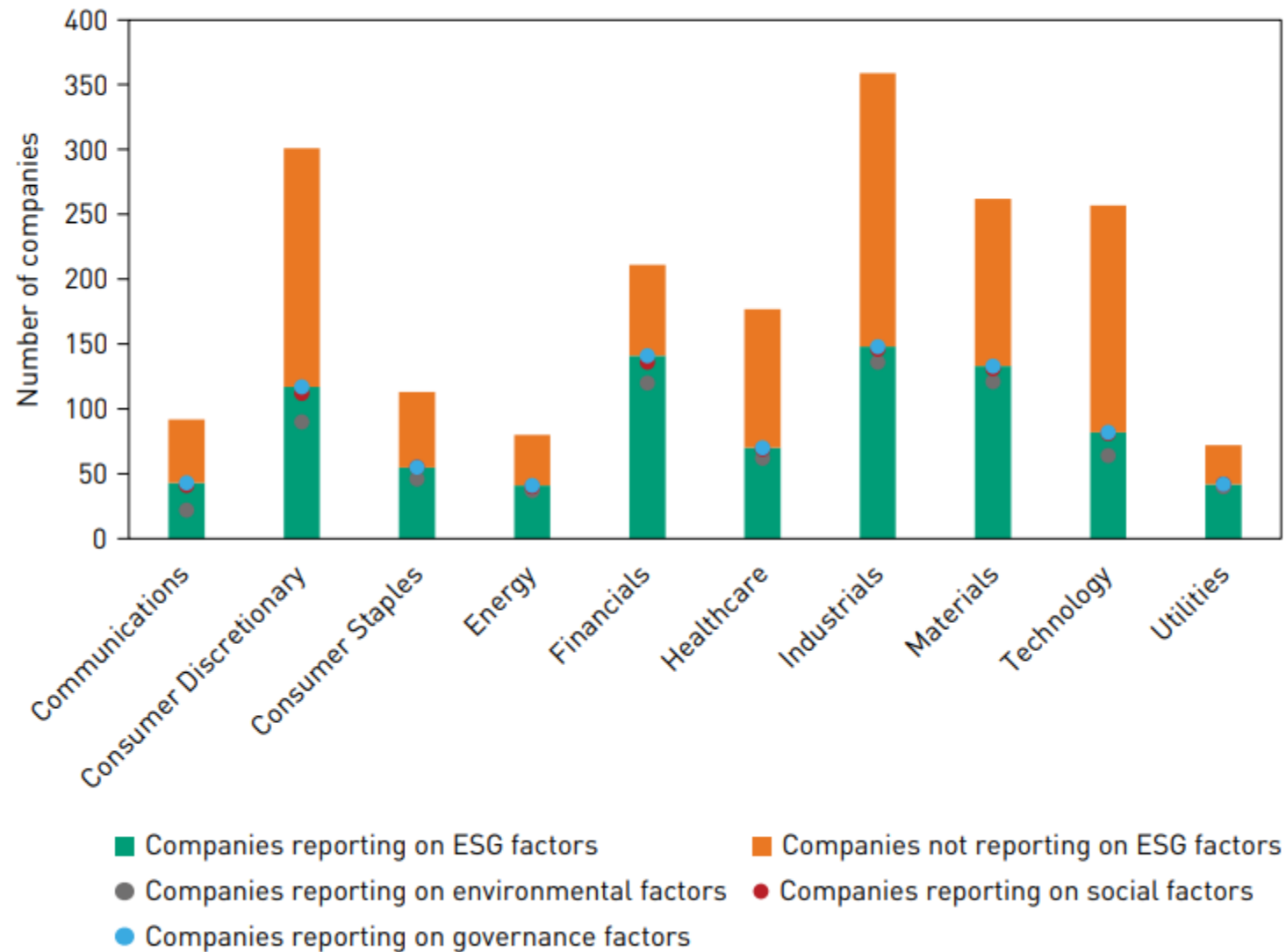
The guidance for enterprise ESG disclosure

- Effective on 1 June 2022
- China's first ESG disclosure guideline
- covers all companies and industries
- applicable to voluntary or mandatory disclosure requirements (if any)
- it adapts ESG standards to fit the Chinese business landscape and the requirements of domestic laws and regulations
 - references to unique features of China's social welfare system, such as social security and the housing provident fund
- more relevant to Chinese investors than standards based off practices in the West

Some basic facts

- Beijing has committed to reach peak carbon by 2030 and to become carbon neutrality by 2060
- China introduced a green finance system in 2016

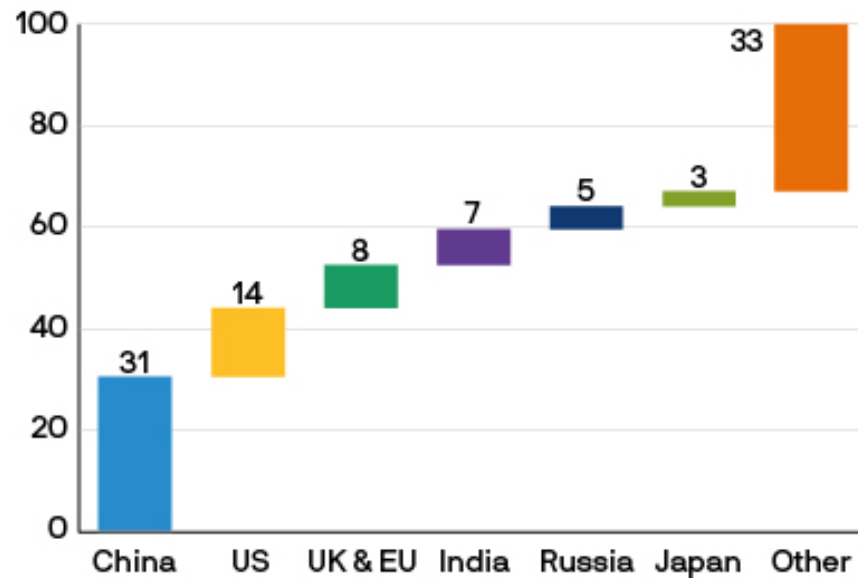
FIGURE 11: LISTED COMPANIES REPORTING AND NOT REPORTING ON ESG FACTORS IN CHINA



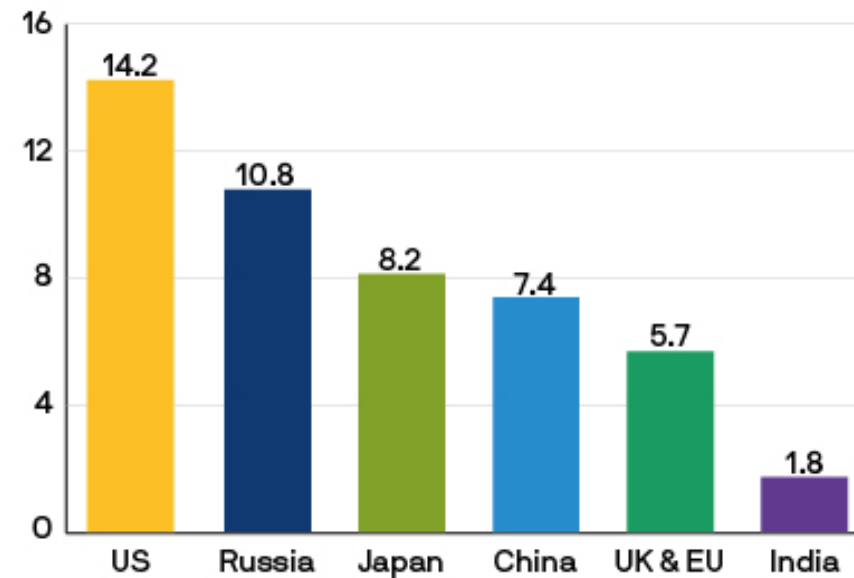
China environmental considerations

Exhibit 2: CO₂ emissions across regions

Share of global CO₂ emissions by country
%, 2020



Global CO₂ emissions per capita
Tonnes, 2020



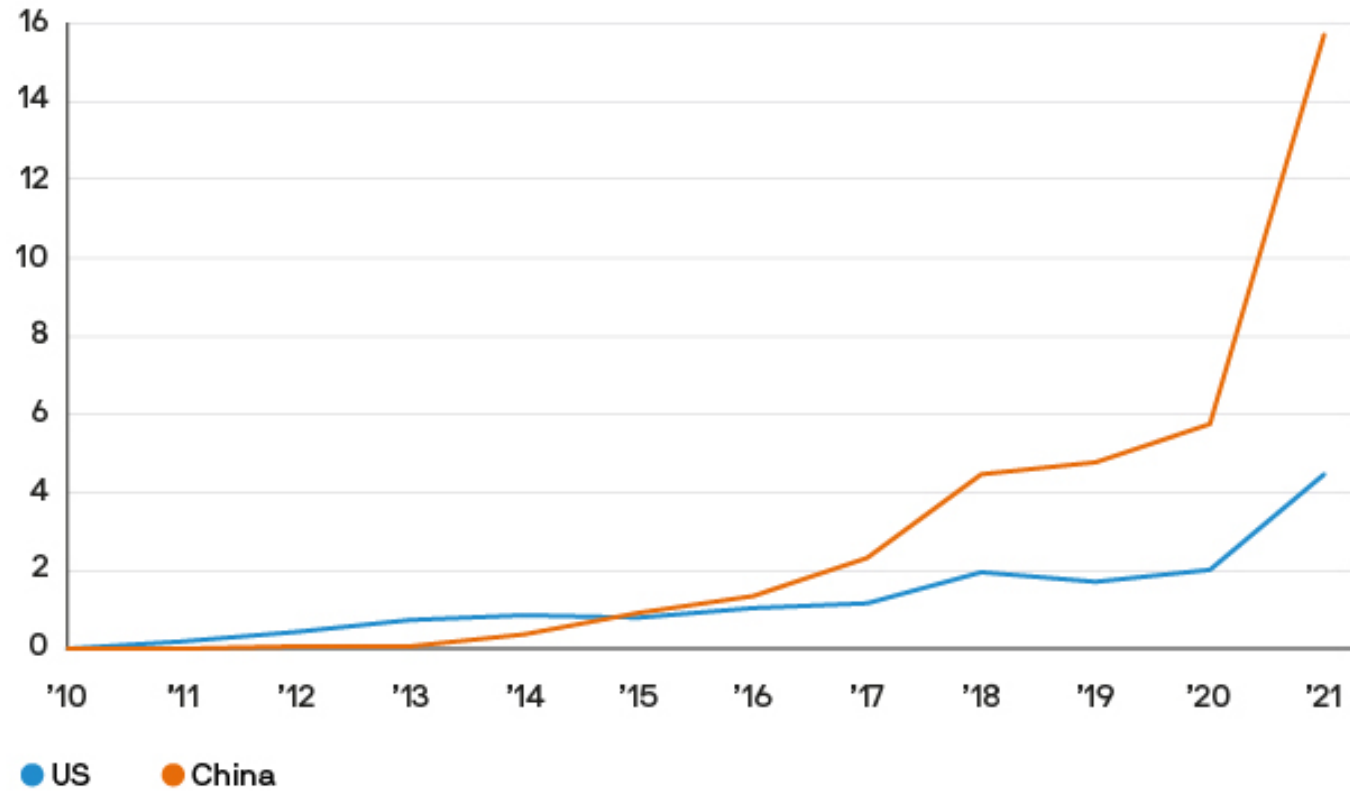
Researchers from the University of Chicago have estimated that *roughly 15% of Chinese emissions are attributable to goods that are exported and consumed abroad.*

China environmental considerations (Cont'd)

- policy is driving the rapid increase in renewable energy infrastructure
 - Plan to take 25% of its energy use from renewables by 2030,
 - By far the biggest manufacturer of renewables equipment, commanding
 - 50% of global wind turbine production
 - 66% of solar panel production
 - 90% of the battery storage market
- China's electric vehicle penetration passed 15% in 2021, target of 20% for 2025
 - electric vehicle penetration in the US is less than 5%
- China's carbon market is now the largest in the world
 - data quality issues have delayed the market's expansion into other industries outside of electricity

Exhibit 3: Electric vehicle sales market share

% of total sales



Source: International Energy Agency, China Passenger Car Association, J.P. Morgan Asset Management. Data as of 11 May 2022.

China social considerations

- treatment of workers
 - 9-9-6 (working practice (9am to 9pm, six days a week) became illegal in 2021
 - broader public health issues relating to living standards, particularly with regards to pollution in cities
 - regulate and move key polluting activities away from densely populated areas
 - air quality in cities, such as Beijing and Shanghai, improved by roughly 50%
- poverty alleviation

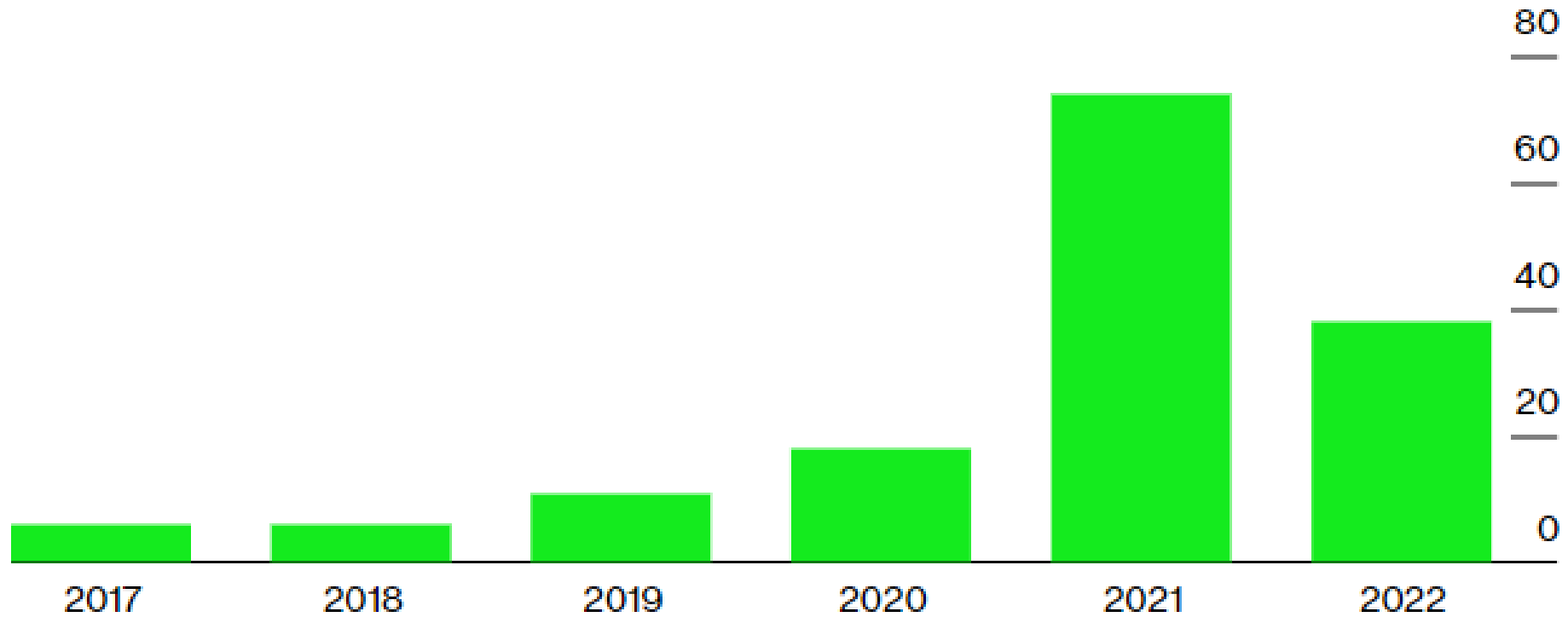
Governance considerations

- state governance and corporate governance are not interchangeable for China investment
- State level: more relevant for fixed income
- Corporate level:
 - governance scores on average are lower than for developed market peers, but closer to those of other emerging market countries.
- corporate governance standards are on an upward trend,
 - particularly in “new economy” sectors, such as technology
 - companies listing on the A-share market
 - More voluntary ESG reporting

ESG Explosion

Chinese ESG fund launches surged in 2021, lifted by Beijing's carbon neutrality and common prosperity campaigns

■ Number of funds launched in each year



Source: Bloomberg

Notes: Available data as of Aug 2022.

Impact of ESG investment

- ESG investing is a positive investment trend in China
- International investors are driving the interest in ESG investing and coming to China with ESG mandates and practices
- Government policies and regulations
 - The CSRC has announced that, by 2020, it will require listed companies to disclose key environmental information in their annual or semi-annual reports.
- Local investment managers are responding to international investors' ESG demands and studying how to integrate ESG factors into their company holdings and portfolios.
- Local companies are looking into how to manage and report on their environmental footprint and trying to understand how to differentiate themselves from their peers.

Fig.1: Percentage of foreign ownership of Chinese equities. Source: Bloomberg

