Journey towards Sustainable Investment

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Joint Committee on Climate Change

Learning Outcomes

Understanding the Risk Management Aspects

- Sustainability Risk vs ESG Risk
- Integrating ESG into investment risk management process and related challenges
- The Investment Approaches in managing ESG risks

Sharing of the Investment Practices

- What is the business cases for integrating ESG?
- Action Steps to Integrate ESG into Financial Analysis

Understanding the Risk Management Aspects

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Sustainability Risk vs ESG Risk

Sustainability Risk

Sustainability risk refers to the uncertainty in being able to sustain the growth of a given because certain practices may have negative externalities which result in the dilapidation of value chain over a period of time

Environmental, Social & Governance (ESG) Risk

ESG risk arises from an adverse environmental, social or governance event, or condition that, if it occurs, could cause an actual or potential material negative impact to the value of the insurer’s assets (and liabilities).

Source: https://envecologic.com/what-is-sustainability-risk/

Sustainability Risk Types

SUSTAINABILITY RISK

ENVIRONMENTAL RISK
activities that bring threat/negative impact to climate change and the overall environmental ecosystem

CLIMATE RISK
are risks arising from climate change events such as changing weather patterns that has long term and/or widespread impact to both natural and human systems

PHYSICAL RISK
is direct impact on assets, productivity and trade disruption arises from event-driven and long-term shift climate-related events

TRANSITION RISK
Is disruption to business as result of adjustment to a low-carbon/"greener" economy

LIABILITY RISK
Stems from legal risk and claims on damages and losses incurred from inaction that results in the effects of physical and transition risks. **(applicable to Insurer's liability book)**

OTHER ENVIRONMENTAL RISK
are risks arising from activities that bring threat/negative impact to pollution, damages to ecosystem & biodiversity and depletion of natural resources

SOCIAL RISK
actions affect surrounding diversity such as human rights, labour standards, consumer protection, health & safety

GOVERNANCE RISK
concerns the way a company is run, of the rights and responsibilities of the management of the company, leadership, management structure

OTHER SUSTAINABILITY RISK
Other practices that bring negative contribution and reducing resiliency of being sustainable .

ESG risks and how it impacts insurer's asset investment

Sustainable investment is about long-term risk management

Such a sustainable investment system will reward insurers' long-term & responsible investment and benefit the environment and society as a whole.

Embedding Environmental, Social and Governance (ESG) risks are among the central factors of managing sustainability risks, to achieve sustainable investment that affect investments' long-term value, refer below:

Environmental

- Direct impacts:
  - climate risk increases the frequency and intensity, leading to potential assets damage.
  - Litigation arising from environmental damage, like oil spill, and damage to brand equity to assets investment.
- Indirect impacts:
  - as consumer preferences shift toward more environmentally friendly products (like electric vehicles) and firms, the industry's disruptor will result to lower and unsustainable revenues.
  - less environmentally friendly companies may also be subject to greater regulatory risk, including higher taxes and fees imposed on emissions affecting their company's returns and values.

Social

- Social risks cover a broader range of issues, such as labour practices including foreign workers, workplace safety, data security, product safety, diversity, staff compensation and benefits to retain talent and higher productivity.
- Prompting consumer and investors' concern, legal action, damage to brand equity
- Threat of regulatory changes can increase costs for firms that aren't managing these risks well.

Governance

- Strong corporate governance is in the best interest of long-term shareholders.
- It promotes accountability and long-term focus by providing transparency and a clear link between long-term value creation and compensation.

Integrating ESG into the Investment Risk Management Process

Examples of ESG-related Risk Aligned to ERM Risk Categories

As the assets are often long-dated to match the duration of the liabilities or related to insurance saving products, they are exposed to credit risk and market risk. In particular real estate may be exposed to weather events.

Credit Risk

- Increase in probability of default due to climate event & exposures to stranded assets
- Increase in country/sovereign risk through lower productivity and economic disruption
- Increase in probability of default in event of negative impact to business model due to:
  - Government, regulatory changes such as implementation of taxes and policy changes
- Lower performance than expected due to revenues impact to Carbon-intensive or less-green industries or technology advancement

Market Risk

- Market value loss due to climate event affecting real estate assets or any financial instruments linked to real-estate
- Lower real-estate values due to geographical in high flood risk areas
- Market value loss due to environmental, societal, legal and technological response

Liquidity Risk

- Assets become less liquid due to increased credit risk
- Possible consequence to requiring liquidating at loss, to pay claim obligations during climate event
- Market sentiment and investors' preference may result in less demand, hence become liquid.

Operational Risk

- Destruction of operational sites.
- Business disruption to support the current and future needs of the business (e.g. office locations, data centres locations, ability of the workforce to travel to office and third party suppliers')

Business Risk

- Impact on Company's capacity to generate sustainable investment profits
- Investment strategies reliant on carbon intensive activities may no longer be profitable
- Risk of lagging behind optimizing regarding new green companies & technologies

Integrating ESG risk considerations into Investment Risk Management processes

Set up effective governance structure covering risk assessment, monitoring to reporting

1: Risk Identification & Assessment

- Identify and analyse investments portfolio that are susceptible to ESG risk:
  - By industry sectors & investee company's
  - Physical assets or investments that are exposed to geographical factor
- Understanding and assessing the underlying transition risks and physical risks of the assets book, to key material risks

2: Risk Measurement & Stress Test

- To factor in current & forward-looking ESG risks impact assessment via ICAAP to determine whether ESG risk is material
- To reevaluate risk framework, risk taxonomies
- To introduce policies and procedures such as negative screening, sector specific policies or impose emission threshold
- Identify primary ESG risk drivers through scenario analysis

3: Risk Control & Mitigation

- Design Sustainable Investment strategy that meets business objectives such as carbon emissions target, objectives to address any societal or environmental issues
- ESG analysis to support decision-making and aligned to risk appetite on how to manage ESG risk such as:
  - Changing exposure to certain sectors or regions
  - ESG assessment for onboarding and the need to reassess to ensure that any change of ESG risk profile are mitigated timely

4: Monitoring

- To facilitate early identification of ESG risks, prompt decision making and actions to mitigate timely
- To reevaluate and link to existing threshold and limits such as SAA, ALM, concentration limits, targets and KRIs
- To monitor % investment exposures in high transition risk industries

5: Reporting

- To develop and maintain set of risk metrics that capture investee company's ESG risks
- Report ESG risk on investment portfolios, to facilitate ESG risk oversight by Management & Board

Key Challenges

Trends from the Industry

Identification

- **Lack of information and inconsistent data**
- Lack of **common standards** and granular indicators
- Inconsistent historical information and coverage
- **Evolving understanding of ESG risk** implications
- **Need of forward-looking data** capturing exposure of ESG hazards
- Assessment of assets to **identify transition risk exposure**
- Model to estimate ESG risk adjusted-probability of default

Quantification

- **New data, tool and modelling practices** including long-term model points for Scenario Analysis
- Combination of **systemic and idiosyncratic risks**
- Integration of ESG and Climate risk scenarios and relevant horizons
- **Quantification as an exact science**
- Forward-looking data to assess current and future strategic directions

Management

- Integrating ESG into risk framework and financial planning
- **Gap of competency and expertise** to understand, assess, manage and monitor ESG risks
- Going beyond regulatory compliance
- Review linkage to strategy and risk appetite
- Awareness and stakeholders involvement

Investment Approaches in managing ESG risks

Sustainable Investment Approach

Investment Approach	Traditional Investing	Responsible Investing	Sustainable Impact Investing	Thematic Impact Investing	Impact First Investing	Impact only
	F	F E S G	F E S G	F E S G	E S G	E S G
Investment Profile	**Limited or no regard** for environmental, social or governance practices	**Mitigate** risky environmental, social or governance practices	**Adopt progressive** environmental, social and governance practices that may enhance value	**Address societal challenges** that generate competitive financial returns for investors	**Address societal challenges** that generate below market financial return for investors	Adverse societal challenges that **cannot generate a financial return for investors**

Impact Goals:

- Delivering Competitive Financial Returns
- Mitigating Environmental, Social and Governance risks
- Pursuing Environmental, Social and Governance opportunities
- Focusing on measurable high-impact solutions

	Traditional Investing	Responsible Investing	Sustainable Impact Investing	Thematic Impact Investing, Impact First Investing, Impact only
	Do not consider or may have significant negative outcomes for people and the planet	**Avoid harm** ESG Negative Screens, to prevent significant effects on important negative outcomes for people & planet	**Benefit** Effect important positive outcomes for various people and the planet	**Contribute to solutions** Have a material effect on important positive outcomes for undeserved people or the planet

F Financial E Environmental S Social G Governance

Source: https://www.structuredfinanceinbrief.com/2020/03/impact-finance-series-the-spectrum-of-capital

Poll Question:

What would you view as the best suit Sustainable Investment approach for your Company within **the next 5 years**?

A. Traditional Investing
B. Responsible Investing
C. Sustainable Impact Investing
D. Thematic Impact Investing
E. Impact First Investing
F. Impact only

Poll Question:

What would you view as the best suit Sustainable Investment approach for your Company within **the next 15 years**?

A. Traditional Investing
B. Responsible Investing
C. Sustainable Impact Investing
D. Thematic Impact Investing
E. Impact First Investing
F. Impact only

Sharing of the Investment Practices

By: *Norlia Binti Md Yusof* (CIO, Etiqa Insurance & Takaful)

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What are the business cases for integrating ESG?

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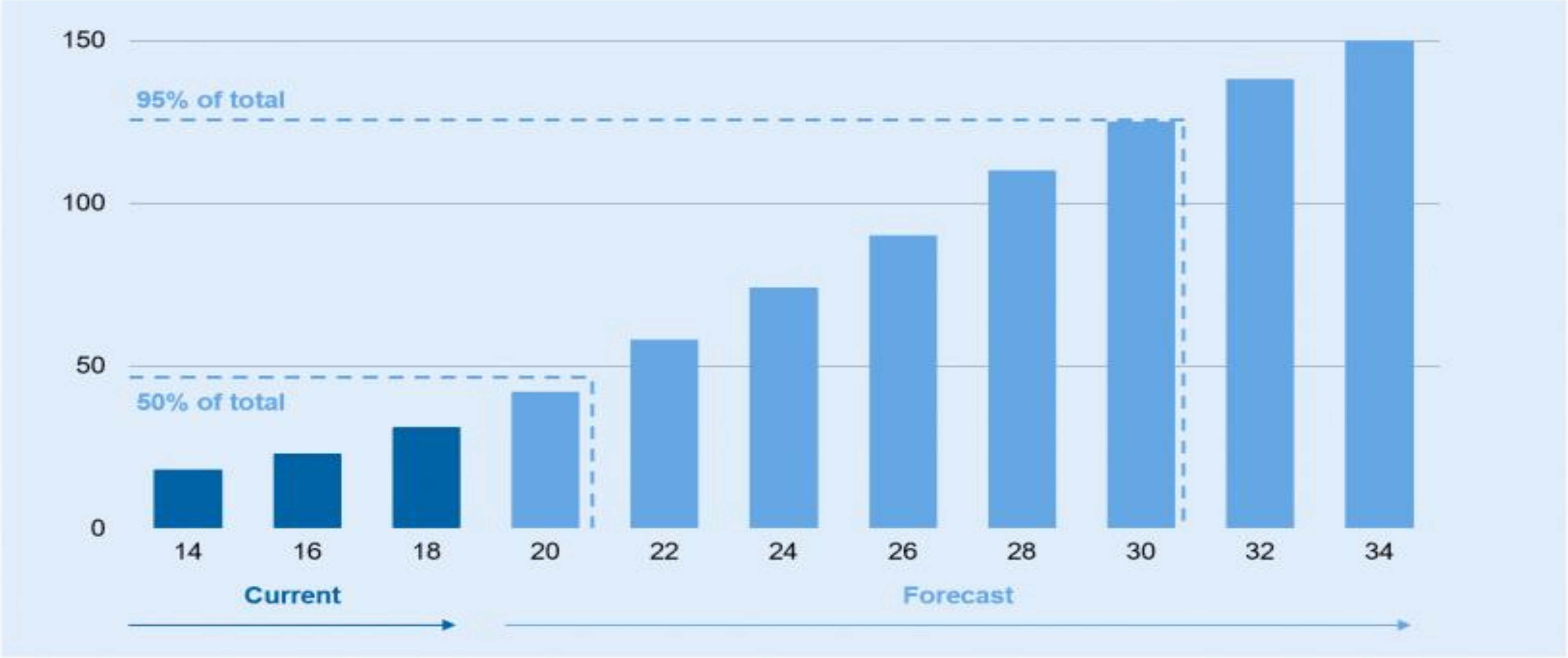
ESG Investments are expected to grow

- ESG investments are expected to further grow and to pass the **USD 100 trillion** mark by 2030



Source: Deutsche Bank, Global Sustainable Investment Alliance, zeb research

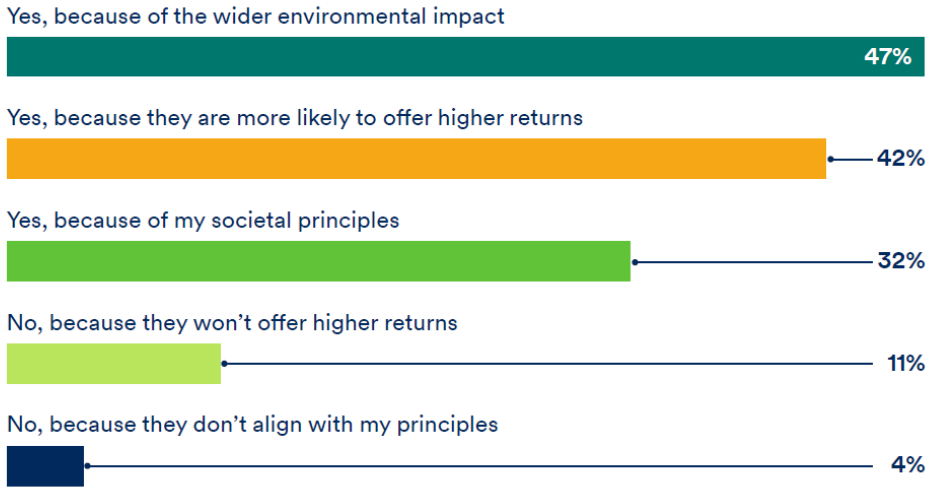
Global AUM invested in ESG mandates (in USD tn)

Source: Moody's Investors Service, 27 Feb 2020

What are the business cases for integrating ESG?

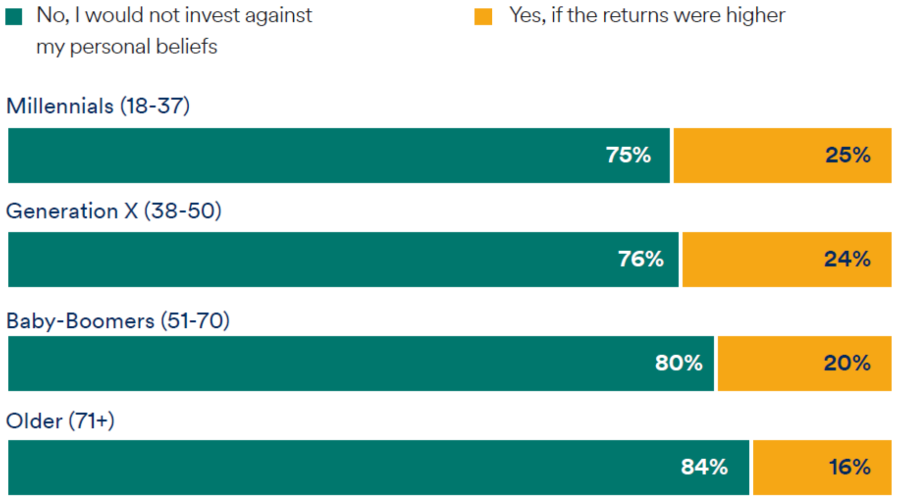
Growing social interest in sustainability and value based investments

Are sustainable investments attractive?



47% of people are interested in sustainable investments as they felt that it has a wider environmental impact. These shows that there's quite a number of people that prioritizes ESG investments because of the impact it has on the environment rather than just merely looking at higher returns

Choice to invest against personal ESG beliefs, by generation



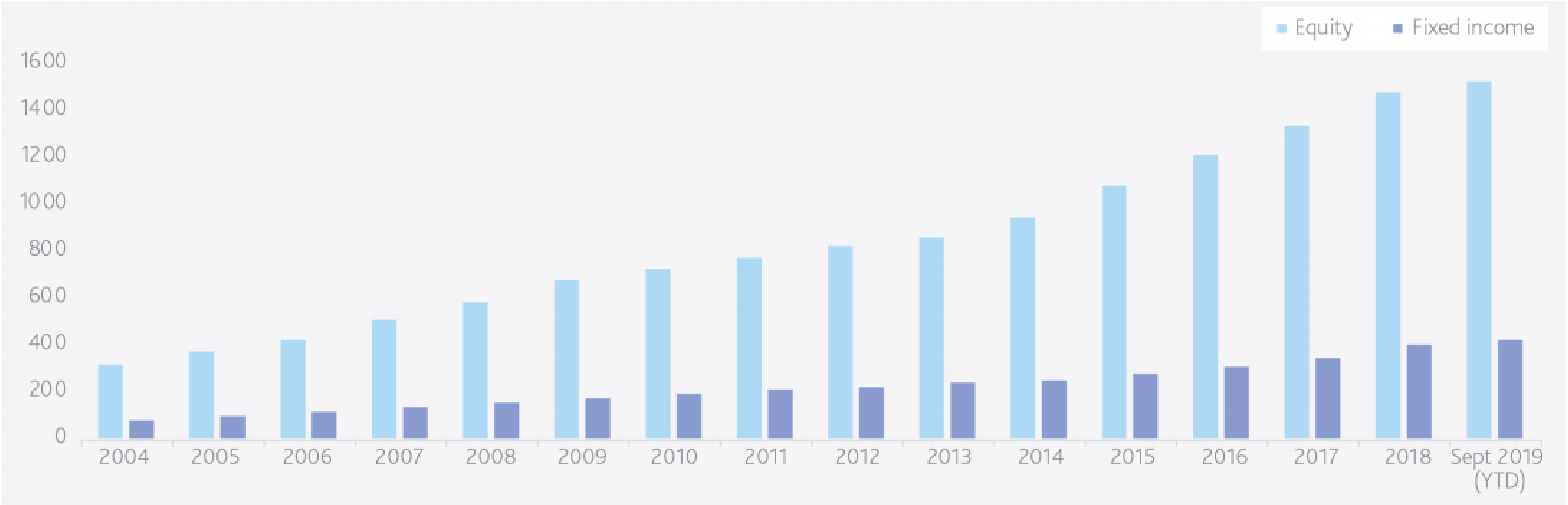
Millennials are often thought of as having a **more sustainable mindset** and being the most proactive generation in this space. It can be seen that the millennials have an awareness of ESG and will invest on their beliefs in ESG investments making ESG investments to be potentially more popular amongst the younger investors

Source: Schroders Global Investor Study 2020.Based on online survey of 23000 people who invest from 32 locations globally, April 2020.

What are the business cases for integrating ESG?

Consumer preferences and regulations drive growth in ESG investments

➢ Growth in the number of ESG investment funds by asset class



Source: International Monetary Fund: Global Financial Stability Report, October 2019, Moody's Investors Service

Regulators are also facilitating the growth and acceptance of ESG products by encouraging more **transparency, disclosure and compliance** around these products, just as they did earlier with passive products.

Source: Moody's Investors Service, 27 Feb 2020

What are the business cases for integrating ESG?

Potential positive returns via ESG investing – Etiqa Malaysia ESG (Pseudo portfolio) vs FBMKLCI

- Using Refinitiv’s ESG data
- Selection of Malaysian stocks under Refinitiv coverage that meets Etiqa’s indicative ESG thresholds
- Using an in-house model to filter, extract data and calculate the ESG scores and performances
- Potentially delivering positive returns via responsible investing

	TOTAL YEAR-ON-YEAR RETURNS	
YEAR	ESG PORTFOLIO	FBMKLCI
2014	-1%	-3%
2015	1%	-1%
2016	3%	0%
2017	19%	13%
2018	-12%	-3%
2019	9%	-3%
2020	4%	6%

Note: Past performance is not indicative of future performance

Source: Bloomberg, Refinitiv, Etiqa, as at 4 February 2021

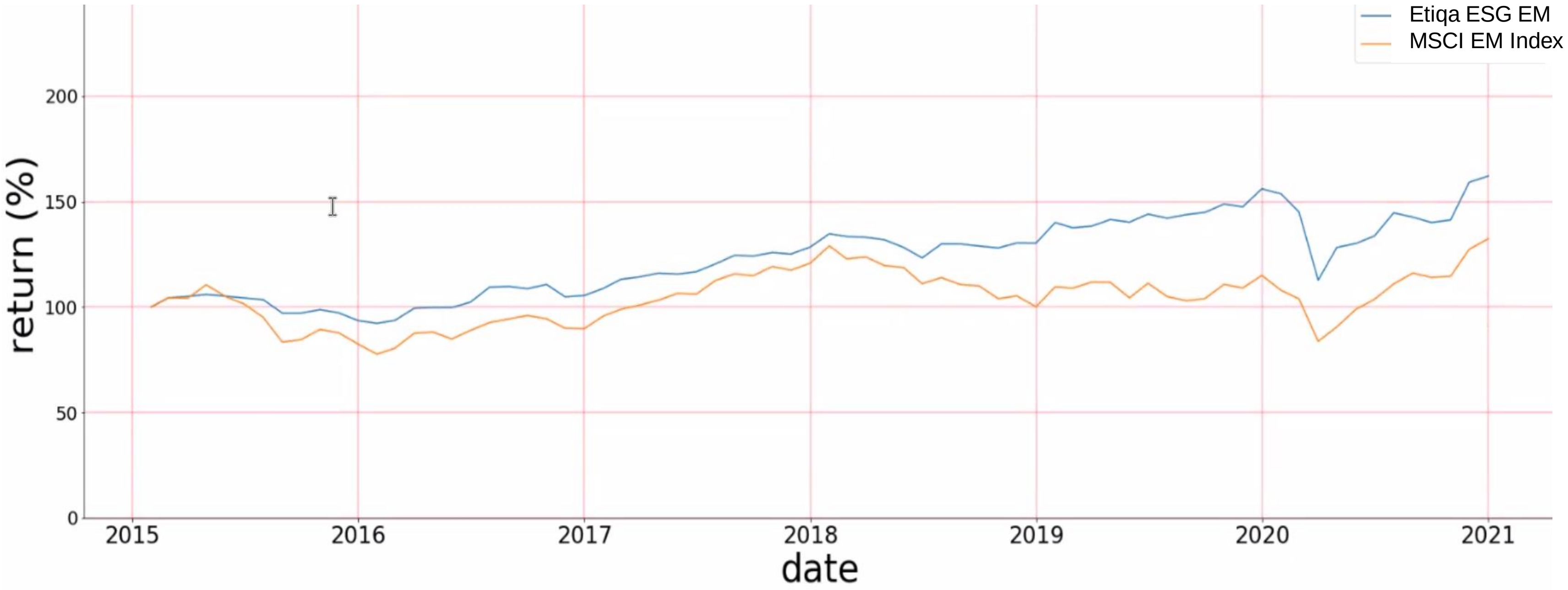
What are the business cases for integrating ESG?

Potential positive returns via ESG investing

– Etiqa ESG Emerging Market (pseudo portfolio) vs MSCI EM Index

- Using Refinitiv's ESG data
- Selection of Emerging Market stocks under Refinitiv coverage that meets Etiqa's indicative ESG thresholds
- Using an in-house model to filter, extract data and calculate the ESG scores and performances
- Potentially delivering positive returns via responsible investing

Etiqa ESG EM vs MSCI EM Index



Note: Past performance is not indicative of future performance

Source: Bloomberg, Refinitiv, Etiqa, as of 4 February 2021

Action steps to integrate ESG into financial analysis

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In a nutshell

Objective:

- **Being able to determine an ESG score of a company and using it to deliver profit to the company from work that benefits humanity**
- This can also indirectly encourage the companies in our current portfolio to report or improve transparency on their ESG performance

Action steps:

Action Step 1 : Accessibility to quality ESG data via ESG Data Providers.

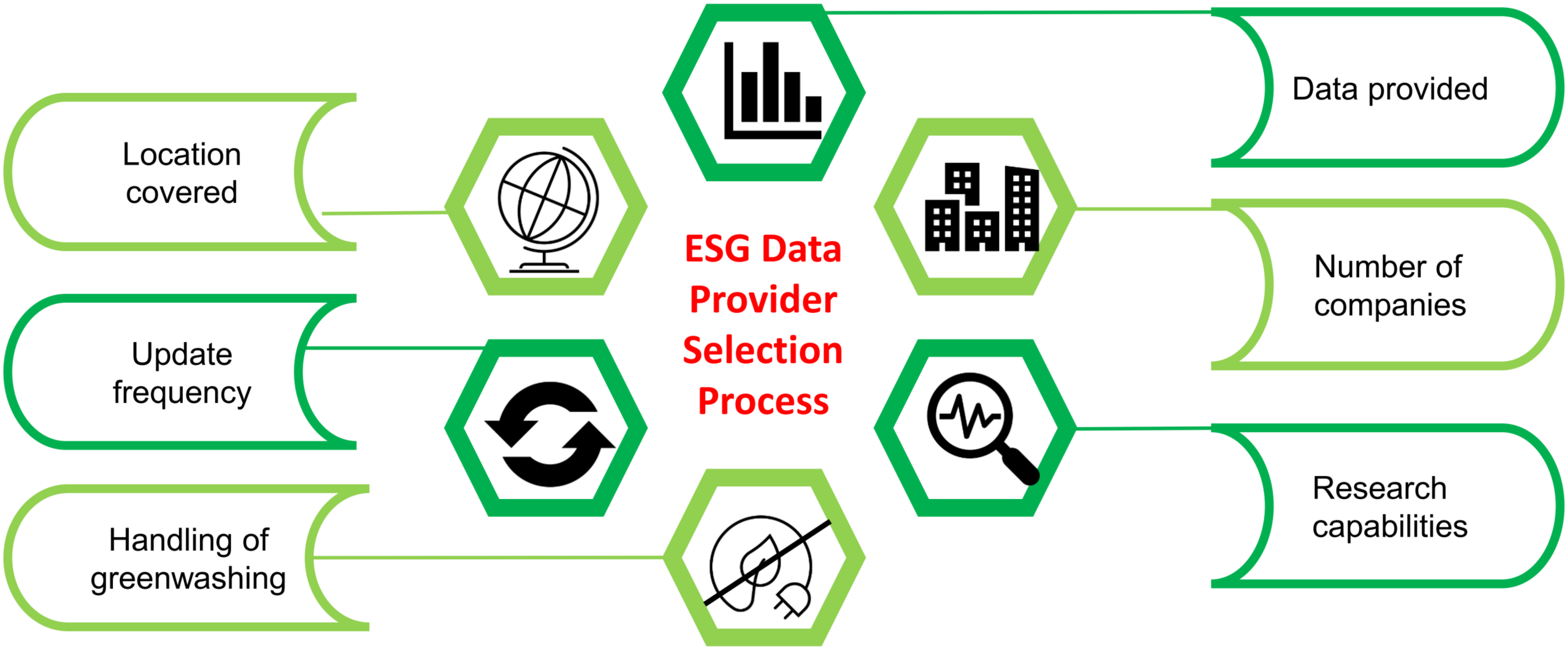
Action Step 2 : Identification of an ESG scoring methodology for fundamental research and security selection process.

Action Step 3 : Development of an in-house ESG model to combine the ESG data and to use the ESG scoring methodology to obtain Etiqa's ESG Score.

Action Step 4 : Collaborations with ESG Partners and to be aligned with regulatory policies.

Action steps to integrate ESG into financial analysis

Action Step 1: Accessibility to quality ESG data – ESG Data provider selection process



Action steps to integrate ESG into financial analysis

Action Step 2: Identification of an ESG scoring methodology

Environmental (E)

Social (S)

Governance (G)

Green Technology

Climate Change

Financial Inclusion & Literacy

Data Security & Privacy

Corporate Governance

Low Carbon Economy

Energy, Water & Paper Consumption

Human Rights

Risk Management

Anti-Money Laundering

- To determine the minimum ESG threshold score required for the companies and sectors
- Setting internal E, S and G weightages for the sectors
- To take various factors and data into consideration like low carbon economy, climate change etc

Action steps to integrate ESG into financial analysis

Action Step 3: Development of an inhouse model which combines the ESG data and the ESG scoring methodology to obtain Etiqa's ESG Score

ESG Data Providers

ESG Scoring Methodology

Name	Maybank ES	Refinitiv ES(	Bloomberg [	Controversie
Nestle Malaysia Bhd	86.87	86.97	62.4	100
Malayan Banking Bhd	83.29	83.19	48.68	100
Hong Leong Bank Bhd	77.27	77.17	45.18	100
AMMB Holdings Bhd	77.25	77.03	46.93	100
CIMB Group Holdings Bhd	76.64	76.53	50	100
Public Bank Bhd	76.40	76.43	36.84	100
MISC Bhd	72.13	72.15	33.47	100
DiGi.Com Bhd	69.59	69.48	53.5	100
UEM Sunrise Bhd	65.57	65.59	44.63	100
Bumi Armada Bhd	64.00	63.8	33.06	100
Sime Darby Property Bhd	63.84	63.95	34.3	100
British American Tobacco Malay	63.67	63.75	44.63	46.08
Fraser & Neave Holdings Bhd	62.69	62.6	52.89	100
Press Metal Aluminium Holdings	62.32	62.34	48.76	100
Axiata Group Bhd	62.24	62.08	38.43	100
RHB Bank Bhd	61.29	61.13	50.88	100
IJM Corp Bhd	56.57	56.47	42.15	100
Malaysia Airports Holdings Bhd	56.45	56.58	45.87	100
Telekom Malaysia Bhd	54.87	54.9	49.79	100
Genting Plantations Bhd	53.93	53.85	42.56	100
Genting Malaysia Bhd	53.90	54.24	45.87	100
Astro Malaysia Holdings Bhd	53.82	53.85	40.08	100
Westports Holdings Bhd	52.69	52.93	45.04	100
IHH Healthcare Bhd	52.64	52.98	28.93	100
SP Setia Bhd Group	51.22	51.47	37.6	100
Bursa Malaysia Bhd	50.92	50.63	49.17	100

Action steps to integrate ESG into financial analysis

Action Step 4: Collaborations with ESG partners and to be aligned with regulatory policies

- To evaluate the benefits of having the collaborations. Eg: Branding and marketing positioning
- To be aligned with policies set by regulatory bodies
- To be aligned with Maybank Group's position on collaborations

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

PRI Principles for Responsible Investment

eTiQa

Thank you! Questions?