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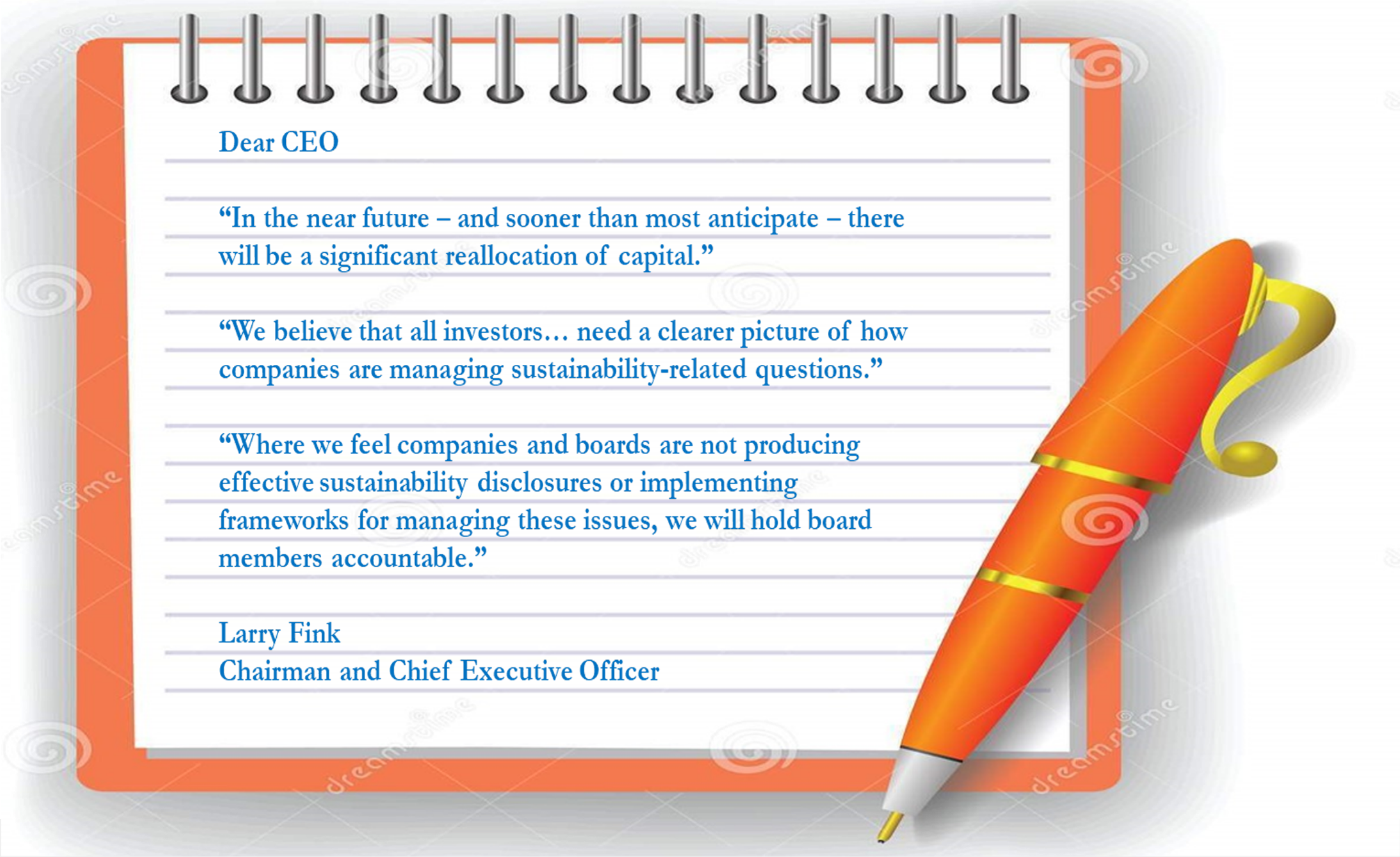
Lessons from Covid-19 in Asia: Through the Lens of Sustainability and ESG

A Fundamental Reshaping of Finance



Dear CEO

"In the near future – and sooner than most anticipate – there will be a significant reallocation of capital."

"We believe that all investors… need a clearer picture of how companies are managing sustainability-related questions."

"Where we feel companies and boards are not producing effective sustainability disclosures or implementing frameworks for managing these issues, we will hold board members accountable."

Larry Fink
Chairman and Chief Executive Officer

Global Sustainable Funds 2Q 2020 Statistics

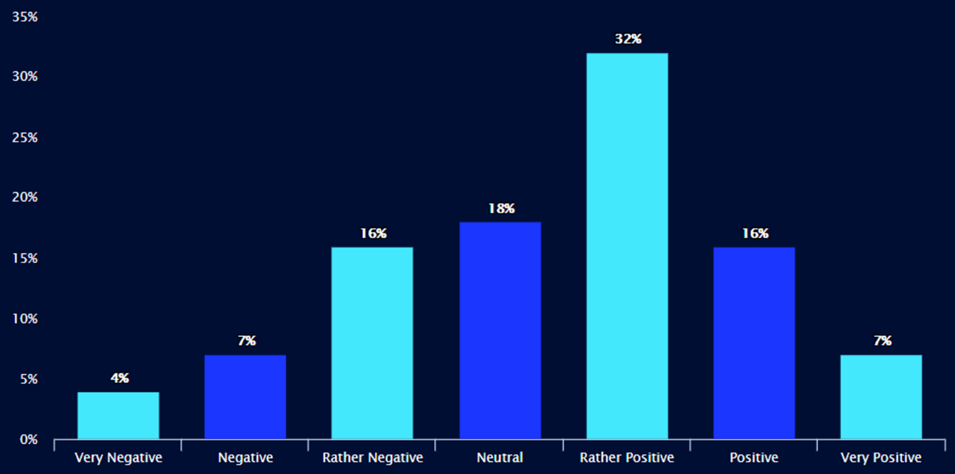
Region	Q2 2020 Flows		Assets		Funds	
	USD billion	% Total	USD billion	% Total	#	% Total
Europe	61.4	86.3	870.3	82.0	2,703	78.8
United States	10.4	14.6	158.9	15.0	315	9.2
Japan	0.0	0.0	4.8	0.4	116	3.4
Australia/New Zealand	0.1	0.2	12.6	1.2	108	3.1
Canada	0.1	0.1	6.5	0.6	91	2.7
Asia ex-Japan	-0.9	-1.3	8.5	0.8	99	2.9
Total	**71.1**		**1061.5**		**3,432**	

Source: Morningstar Direct. Morningstar Research. Data as of June 2020.

Impact of Covid-19 on ESG

Investor expectations of the impact of the pandemic on ESG have a positive skew

Distribution of responses to Question 6 in our investor survey: “In your view, what will be the implications of the COVID-19 crisis for ESG investment momentum in the next 3 years?”



Source: J.P. Morgan, Results from the survey “Tracking the ESG implications of the COVID-19 Crisis”

Impact of ESG Issues

TABLE 1: THE IMPACT OF ESG ISSUES IN 2017 AND THE EXPECTED IMPACT IN FIVE YEARS' TIME (2022) ON SHARE PRICES, CORPORATE BOND YIELDS/SPREADS, AND SOVEREIGN DEBT YIELDS

	AFFECTED IN 2017	WILL AFFECT IN 2022
ESG ISSUES IMPACT ON SHARE PRICES		
Governance	64%	73%
Environmental	24%	59%
Social	30%	55%
ESG ISSUES IMPACT ON CORPORATE BOND YIELDS/SPREADS		
Governance	43%	60%
Environmental	15%	48%
Social	17%	42%
ESG ISSUES IMPACT ON SOVEREIGN DEBT YIELDS		
Governance	32%	49%
Environmental	14%	41%
Social	19%	41%

Note: Percentages represent respondents who answered “often” or “always.”

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Janet LevyPahima, International Department
Herzog Fox & Neeman

"Never doubt that a small group of thoughtful, committed, citizens can change the world. Indeed, it is the only thing that ever has."

Anthropologist Margaret Mead

"We believe that pandemics and environmental risks are viewed as similar in terms of impact, representing an important wake-up call for decision makers. The impacts of the COVID-19 crisis on the real economy and the financial system highlight the limits of most forecasting models."

Jean-Xavier Hecker & Hugo Dubourg Co-Heads of Sustainability & ESG Research J.P. Morgan

One Step Back

SRI (Socially Responsible Investing) is an umbrella term for investing strategies that account for the social implications of their capital allocation. There are several SRI approaches, the main ones being Impact Investing, ESG Investing and Ethical Investing.

Definitions from the Financial Times Lexicon

"ESG (environmental, social and governance) is a generic term used in capital markets and used by investors to evaluate corporate behaviour and to determine the future financial performance of companies."

"ESG factors are a subset of **non-financial performance indicators** which include sustainable, ethical and corporate governance issues such as managing the company's carbon footprint and ensuring there are systems in place to ensure accountability."

The Basics of ESG

Environmental Criteria

- Waste and pollution
- Resource depletion
- Greenhouse gas emission
- Deforestation
- Climate change

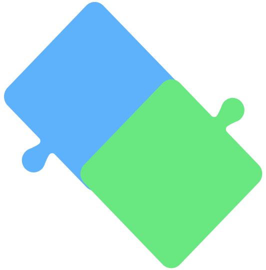
Social Criteria

- Employee relations & diversity
- Working conditions child labor & slavery
- Local communities; seeks explicitly to fund projects or institutions that will serve poor and underserved communities globally
- Health and safety
- Conflict

Governance Criteria

- Tax strategy
- Executive remuneration
- Donations and political lobbying
- Corruption and bribery
- Board diversity and structure

The move from Corporate Social Responsibility (CSR) to ESG



CSR = a company's efforts to have a positive impact on its employees, consumers, the environment and wider community. Self-regulation; most large companies report annually.

ESG demands metrics: kilowatts of energy saved, tons of carbon emissions avoided, or gallons of water preserved – with targets.

Global Trends

- 2018 S&P Global launched "ESG Evaluation" criteria. S&P's "Risk Atlas" evaluates environmental and social risks on a scale of 1 (low exposure) to 6 (high exposure). First ESG Evaluation published June 2019 analyzing NextEra Energy Inc., an American energy company headquartered in Florida.
- MSCI (formally Morgan Stanley Capital International), has different ESG indexes to weigh ESG values verses the financial objectives of investors. MSCI ESG Metrics, a tool that measures environmental, social, and governance data for 8,500 companies worldwide.
- Sustainalytics has an ESG "Risk Ratings" system, which quantifies five levels of risk: negligible, low, medium, high, and severe, used by major institutional investors, such as Putnam, State Street Global Advisors (SSGA), T. Rowe Price.
- ISS has a suite of ESG ratings products that range from company-specific scores to sustainability bond ratings and carbon risk ratings. The ESG Corporate Rating is similar to that of MSCI and Sustainalytics', where analysts review a company's ability to manage ESG-related issues.

Global Trends (continued)

- The Global Reporting Initiative (GRI) - international organization that helps businesses and governments better communicate their individual initiatives pertaining to climate change, human rights, and fighting corruption. GRI's ESG reports are distributed to multinational corporations and organizations, governments, NGOs, and industry groups in over 90 countries.
- The Carbon Disclosure Project (CDP), a non-profit organization based in the United Kingdom, has been collecting ESG data on over 6,000 companies.
- The Sustainability Accounting Standards Board (SASB) is a non-profit organization that solicits input from both businesses and institutions to develop solid social and environmental accounting standards for disclosure as it pertains to publicly traded U.S. companies.
- United Nations Global Compact, which was first announced in 2000, is a non-binding pact which encourages global businesses to adopt environmentally and socially friendly policies. Based on ten simple principles, centered on human rights, labor, environmental, and anti-corruption benchmarks. An estimated 12,000 companies in over 160 countries have signed on.

The Israeli ESG Scene

- Israel does not have specific ESG disclosure regulations however, under reporting obligations of public companies by the Securities Authority and Stock Exchange, all "material" relevant information must be reported.
- Investors are becoming increasingly sensitized in Israel towards ESG, following global awareness.
- Currently the Israel Securities Authority has issued a request for comment to explore whether ESG reporting should be instituted and if so, should it be mandatory or voluntary and according to what standards.
- Maala has a voluntary CSR/ESG index rating over 150 companies in 2020.
- Start Up Nation Central has Finder: a free data base with information on thousands of Israeli start ups. SDGs [UN Sustainable Development Goals] are one of the filters to find companies.
- Several social impact bonds have been launched in Israel through Social Finance Israel. They are in ground-breaking areas like diabetes prevention and alleviating loneliness among senior citizens.

Add In COVID

Challenges in short and medium term:

- Remote working
- Need for greater flexibility with the closure of schools, online learning, and alternating shifts for school children

Results:

- Productivity: some companies found productivity remained constant or even improved while employees did not have to commute
- Cost savings: reconsider office space, face time and business travel that were considered part of doing business.
- Studies say many ESG funds outperformed others. According to Forbes [May 2020], it depended more on sectors. Those focused on Tech did better than those focused on energy.

Dissection of a Virus

21st Century’s first “sustainability” crisis

- COVID-19 impacted every sector and every country.
- Pandemics were not factored in as risk factors – nor would it have helped.
- COVID-19: the “S” in ESG.
- Short-term: how to keep employees safe; how to handle illness and caregiving responsibilities; how to manage employees working remotely; how to check on employees’ mental health.
- Longer-term: impact on increase of employees working remotely; impact of reduced workforce; and implications including health risk of business meetings and travel.
- “G”: COVID-19 shows need for effective corporate governance practices. Companies need to mobilize quickly and effectively to protect facilities and (if possible) maintain critical operations.

Dissection of a Virus (continued)

21st Century's first "sustainability" crisis

- Possible result: investors may ask how companies treat their employees and other stakeholders, like suppliers, customers and their communities.
- And the "E": climate change – a global risk to people and planet
- The World Health Organization estimates that climate change will result in over 250,000 additional deaths per year between 2030 and 2050, resulting from increased malnutrition, malaria, diarrhea and heat stress alone.
- Add to that extreme weather events, particularly flooding, leading to increase in water-borne diseases and diseases transmitted through insects and other cold-blooded animals.

Investor Response

- Global Stats
- Companies claiming to follow ESG principles approaching 44% of global AUM (assets under management)
- ESG-dedicated funds around $1 trillion (2% of global AUM)
- J.P. Morgan poll:
- 71% of investors said, “rather likely,” “likely,” or “very likely” that the occurrence of a low probability / high impact risk, such as COVID-19, would increase awareness and actions globally to tackle high impact / high probability risks such as those related to climate change and biodiversity losses.
- Principles for Responsible Investment (UN PRI) (founded 2006) survey: 64% of respondents said that COVID-19 brought social issues onto their radar like occupational health and safety, social safety nets, worker protection, responsible purchasing practices and supply chain issues, as well as diversity and digital rights, including privacy.

Source: J.P. Morgan Global Equity Research, 2020 J.P. Morgan Global ETF Handbook.

Trending in Asia

Quote by JP Morgan:

"Asia has long been a laggard in ESG investing, but the movement is now spreading there too and ESG disclosures regulations are being adopted or discussed in multiple jurisdictions. Japan has been among the first to adopt the trend and one of the most symbolic changes has been the Japanese Government Pension Investment Fund signing the Principles for Responsible Investment in 2015."

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A changing tide:

The evolving relevance of climate change to commercial practice

Sarah Barker, Head of Climate Risk Governance
MinterEllison

Climate risk through a finance & liability lens

2014

What has changed?

2020

Over the horizon in Asia?

Climate change is an ethical, environmental, non-financial issue

Relevance: environment & planning laws, tax, customer relations

Climate change is a material financial and legal risk issue

Relevance: corporate governance & directors' duties, securities fraud/misleading disclosure, human rights climas; mergers & acquisitions; project & corporate finance; fund structuring; insurance; prudential & capital regulatory requirements

Overview

1. Why is climate change a financial risk issue?

3 kinds of financial risk

- Physical
- Economic transition
- Liability

2. What has changed in the last 12-18 months?

3 kinds of ratchet

- Regulatory ratchet
- Investor ratchet
- Litigation ratchet

3. Forthcoming developments in Asia?

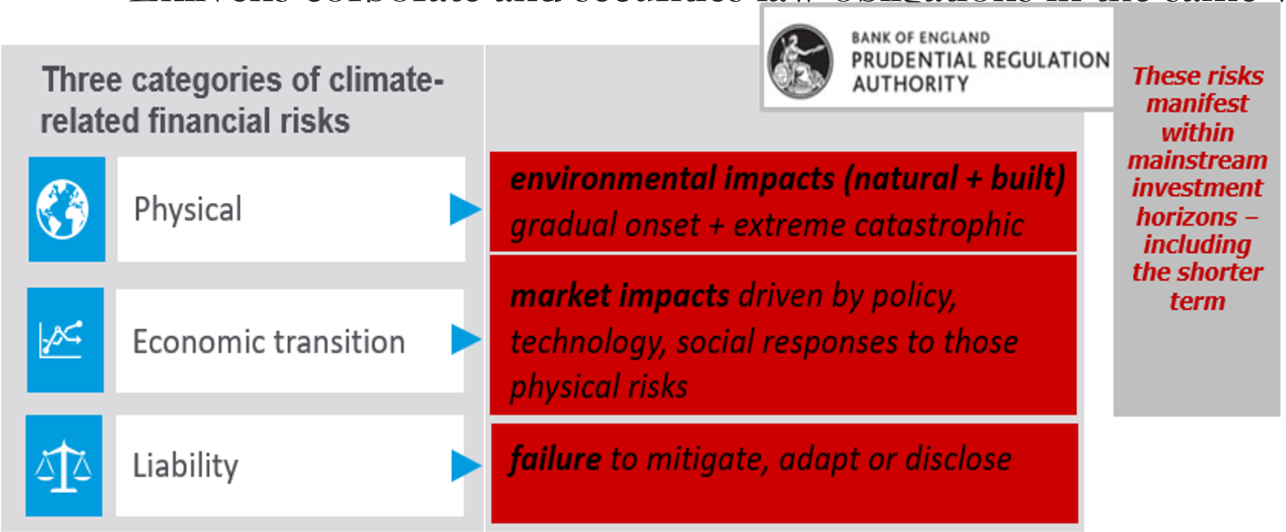
Work on foot in 3 key jurisdictions

4. What does this mean for commercial practice?

3 key questions

Climate as a foreseeable financial risk - overview

- Enlivens corporate and securities law obligations in the same way as any other financial



rospects

Regulatory ratchet: *net zero*

- ***Paris Agreement* - net zero emissions *by* 2050**
- UK, EU, NZ, California, NY…
- …plus South Korea - Green New Deal, Japan – Prime Minister Yoshihide Suga, and China by 2060
- ***Associated developments* - trade and prudential regulation**

PARIS AGREEMENT

The Parties to this Agreement,

Being Parties to the United Nations Framework Convention on Climate Change, hereinafter referred to as "the Convention",

Pursuant to the Durban Platform for Enhanced Action established by decision 1/CP.17 of the Conference of the Parties to the Convention at its seventeenth session,

In pursuit of the objective of the Convention, and being guided by its principles, including the principle of equity and common but differentiated responsibilities and respective capabilities, in the light of different national circumstances,

Recognizing the need for an effective and progressive response to the urgent threat of climate change on the basis of the best available scientific knowledge,

Also recognizing the specific needs and special circumstances of developing country Parties, especially those that are particularly vulnerable to the adverse effects of climate change, as provided for in the Convention,

Taking full account of the specific needs and special situations of the least developed countries with regard to funding and transfer of technology,

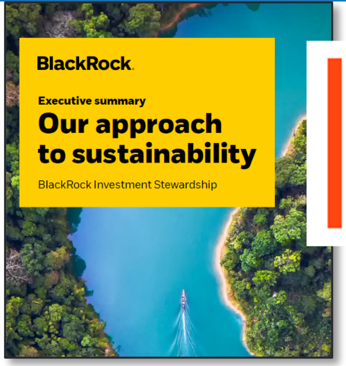
Recognizing that Parties may be affected not only by climate change, but also by the impacts of the measures taken in response to it,

Emphasizing the intrinsic relationship that climate change actions, responses and impacts have with equitable access to sustainable development and eradication of poverty,

Recognizing the fundamental priority of safeguarding food security and ending hunger, and the particular vulnerabilities of food production systems to the adverse impacts of climate change,

The investor ratchet: *despite Covid*

"[I]ndustry needs to show investors and regulators what it has achieved on ESG issues, not what it thinks is important"
(22 April 2020)



In 2020, we identified 244 companies that are making insufficient progress integrating climate risk into their business models or disclosures. Of these companies, we took voting action against 53, or 22%. We have put the remaining 191 companies 'on watch.' Those that do not make significant progress risk voting action against management in 2021.

BlackRock

Legal & General
INVESTMENT MANAGEMENT

BNP PARIBAS

STATE STREET

Allianz

DWS

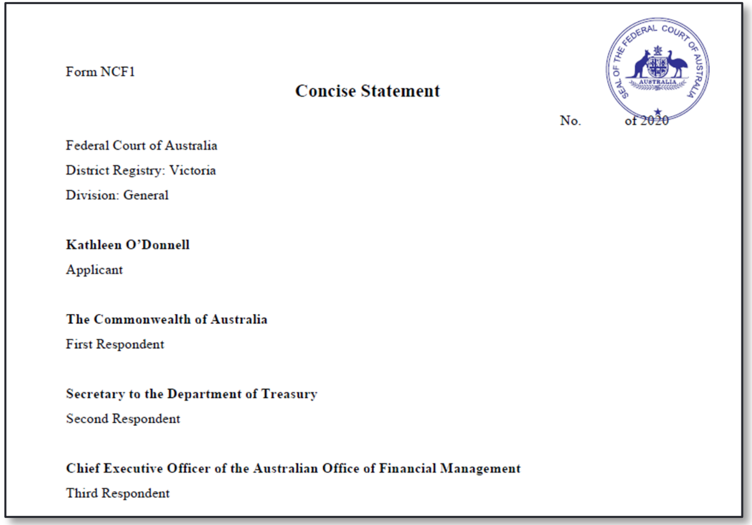
2020 proxy focus

- Proxy focus:
  - Net zero – target & credible pathway
  - Scope 3
  - Lobbying
  - Remuneration

- *Barclays, JP Morgan, Mizuho Financial, Woodside, Santos, QBE, Suncorp etc etc*

Claudio Munoz, *The Economist*, 9 March 2013

The litigation ratchet: *duties and disclosure*


Form NCF1

Concise Statement

No. of 2020

Federal Court of Australia
District Registry: Victoria
Division: General

Kathleen O'Donnell
Applicant

The Commonwealth of Australia
First Respondent

Secretary to the Department of Treasury
Second Respondent

Chief Executive Officer of the Australian Office of Financial Management
Third Respondent

- *O'Donnell v Cth & Ors* (21 July 2020)
- Alleges:
  - Retail purchaser (exchange-traded sovereign bond) alleged failure to disclose climate risk impacts on Commonwealth credit risk misleading
  - Failure by officers to ensure adequate disclosure a breach of statutory duty of due care and diligence
- *Consider: robustness of climate-related risk information gathering, verification and disclosure processes?*

Over the horizon in Asia?

- Australia: Hutley Opinion (2016, 2019) *(instructed by MinterEllison)*
- UK: Debevoise & Plimpton on ESG (2019)
- New Zealand: Chapman Tripp (2019)
- Canada: Hansell Opinion (2020)
- **Singapore: *Chan Opinion (forthcoming)***
- **Hong Kong: *Stock Opinion (forthcoming)***
- **India, Japan, Korea: *currently being briefed***

COMMONWEALTH
Climate and Law Initiative

Questions for all commercial practitioners

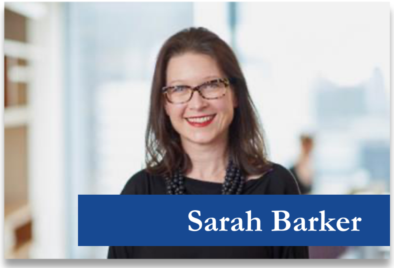
Do we consider climate change through a financial, as well as environmental, risk lens?

Opportunity: **To which areas of our practice does climate-related finance and liability impact?**

Risk: **What specialist expertise should we bring in to protect our clients` interests?**

Eg. Specialist due diligence modules, green finance, misleading disclosure advisory?

Questions?



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