



ESG VIEWPOINT

Emerging responsible investment trends in Asia

At a glance

- The appetite for responsible investment is growing in Asia on the back of evolving regulation and continued client demand.
- There is a proliferation of responsible investment policy across the region, particularly corporate Environmental, Social and Governance (ESG) disclosures, sustainable finance taxonomies and stewardship codes.
- Financing the transition remains a key ESG theme in Asia.
- Social issues such as a just transition, supply chain due diligence and gender diversity are gaining prominence.



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Introduction

A recent trip by members of Columbia Threadneedle Investments' responsible investment team to Tokyo for Principles for Responsible Investment (PRI) in Person – the world's largest responsible investment conference – confirmed the significant appetite for responsible investment in Japan and across Asia, as well as the region's commitment to developing a dynamic and well-functioning sustainable and responsible investment market.

Responsible investment practices in Asia have often been perceived to lag global peers. This is usually attributed to historic barriers, such as a limited understanding of ESG issues and how to integrate these into the investment process, as well as a lack of standardised and comparable ESG data.¹ These barriers are slowly being overcome, with a growing recognition of the materiality of ESG issues, particularly environmental and

social ones, following the recent flurry of net zero and carbon neutrality commitments from Asian governments and in the wake of the social issues brought to light by the COVID-19 pandemic. Improvements in the quantity and quality of corporate ESG disclosures – driven by investor engagement, stock exchanges, regulation and an emerging consensus on a global sustainability reporting standard – have helped to support the integration of ESG issues into the investment process.

Greater awareness of ESG issues and their materiality has created significant client demand for ESG incorporation and products among investors in Asia. The market share of ESG funds in Asia has doubled since the end of 2020, with Asian-focused ESG fund inflows growing faster than any other region.² Meanwhile, Asian signatories to the PRI have also doubled between 2020 and 2023, to over 500 members.³

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¹ CFA Institute and PRI ESG Integration in Asia Pacific: Markets, Practices and Data

² Bloomberg (January 2023)

³ Principles for Responsible Investment signatory directory



Asia's evolving regulatory environment

After Europe, Asia has seen the largest growth in sustainable finance policy instruments globally, with Asian regulators using a host of sustainable finance policy instruments.⁴ These include moving beyond voluntary corporate ESG disclosures towards mandatory implementation, while the growth in assets under management allocated to responsible investment has led regulators to adopt ESG fund disclosures and labelling regulation, to tackle greenwashing. Additional focus areas for Asian policymakers have also been sustainable and green finance taxonomies, and the introduction and revision of stewardship codes.

Despite significant differences in the capital markets, ownership structure and broader corporate governance of firms across Asia, compared to other markets, we have seen a proliferation in stewardship codes across Asian markets.⁵ These have largely been transposed into their respective markets following the introduction of the UK Stewardship Code in 2010. More recent revisions to several codes (for example, the revision of Japan's code in 2020), as well as recent revisions to the Malaysia,

Singapore and Taiwan codes, indicate a growing interest among regulators in fostering constructive dialogue between investors and companies in the best long-term interest of clients and beneficiaries.⁶

In recent years, there has also been a proliferation of national and regional green and sustainable finance taxonomies, as regulators aim to provide clarity for market participants on what is considered a green and/or sustainable activity or technology, reduce the risks of greenwashing, and seek to channel investments into these activities. While the aims are similar to other global taxonomies, namely the EU taxonomy, one of the key differences of many Asian taxonomies is the use of a 'traffic light' approach; importantly, this includes an 'amber' category for technologies or economic activities that contribute towards economies' low carbon transition.

While the growth in sustainable finance policy across Asia has helped to develop the market, the approach remains heterogeneous, creating a fragmented regulatory environment that could lead to difficulties in implementation going forward.

⁴ PRI Regulation Database

⁵ Principles for Responsible Institutional Investors - Japan's Stewardship Code (2014); Malaysian Code for Institutional Investors (2014); Hong Kong Principles for Responsible Ownership (2016); Taiwan Stewardship Principles for Responsible Investors (2016); Singapore Stewardship Principles for Responsible Investors (2016); South Korea Principles on the Stewardship Responsibilities of Institutional Investors (2016); Thailand Investment Governance Code for Institutional Investors (2017); India Stewardship Code for Mutual Funds (2019).

⁶ CFA (2020) Stewardship 2.0 Awareness, effectiveness, and progression of stewardship codes in Asia Pacific



Key material ESG issues in Asia

Climate change: the importance of focusing on the transition

While Asian economies are highly diverse, they face a shared challenge of maintaining economic development, while simultaneously transitioning their economies to meet the goals of the Paris Agreement. Growing populations, rising incomes and urbanisation will increase energy demand in the region. With approximately 85% of current Asian energy demand being met by fossil fuels, this is anticipated to increase Asia's share of global greenhouse gas emissions, despite the per capita footprint being lower than the global average.

In particular, the early phase-out, retirement and repurposing of coal-fired power generation presents unique challenges for Asia. Asian countries account for almost 80% of coal consumption globally, with a coal fleet of an average age below 15 years – significantly lower than the US and Europe.⁷ This will require both concerted policy action and financing to accelerate the end-of-life of these assets, to reduce emissions and meet the goals of the Paris Agreement. Financing mechanisms, such as the Asian Development Bank's Energy Transition Mechanism being piloted in Indonesia, represent a promising approach.⁸

The challenges associated with Asia's power sector transition, coupled with economies made up of high-emitting and hard-to-abate sectors (including cement, steel and shipping), place an important emphasis on responsible investors focusing on the transition.⁹ There has been a growing focus on transition finance to support high-emitting sectors with real-world emissions reductions, with Asian countries and companies leading the way in transition bond issuance.¹⁰ While questions remain around how to assess the credibility of transition plans and activities, as well

as how to measure and verify the real-world emissions reductions, it appears that transition financing will continue to gain further traction in the region, particularly following the release of the Asia Transition Finance Guidelines last year.¹¹

The low carbon transition also represents a significant opportunity for Asia, with an estimated investment opportunity in energy supply between US\$26-37 trillion from 2020 to 2050.¹² Several Asian countries and companies are also leading the way in the manufacturing of products to support the low carbon transition, particularly across the electric vehicle and renewable energy value chains.

Asia is also highly exposed to acute and chronic physical climate risks, such as extreme weather events, heat waves and flooding. This is coupled with high vulnerability, in part due to a combination of low-lying, densely populated coastal areas, significant agricultural sectors and limited resources for adaptation. Swiss Re estimate that a 2.6 degrees Celsius temperature rise could cost Asia 26.5% of GDP by 2050.¹³ Others estimate that 99 out of the 100 cities that are most exposed to environmental risks globally, including water availability, heat stress and natural hazards, are in Asia.¹⁴

The need for a just transition in Asia

It is important for responsible investors to have an understanding of the social and economic impacts on workers and communities from the low carbon transition, and the broader risks and impacts this could pose to economies, sectors and companies.

There remains 350 million people across Asia who have limited access to electricity.¹⁵ Meanwhile, 8.4 million people worldwide

⁷ IEA Coal 2022 and Average age of existing coal power plants in selected regions in 2020

⁸ Asian Development Bank Energy Transition Mechanism

⁹ Columbia Threadneedle Investments have developed a proprietary Net Zero Model which looks to assess companies in a forward-looking way on their alignment with the goals of the Paris Agreement. Find out more about our Net Zero Model and approach here.

¹⁰ Climate Bonds Initiative (April 2023) Sustainable Debt Global State of the Market 2022

¹¹ Asia transition finance guidelines (September 2022)

¹² AIGCC (March 2021) Asia's Net Zero Energy Investment Potential

¹³ Swiss Re (April 2021) The economics of climate change: no action not an option

¹⁴ Verisk Maplecroft Environmental Risk Outlook 2021

¹⁵ Asian Development Bank's Working in the Energy Sector



work in the coal value chain, with over 80% of these jobs in China, India and Indonesia. As coal demand and consumption falls, the International Energy Agency estimate significant coal-related job losses. However, only five countries representing 4% of the world's coal workers have announced transition policies for workers and communities affected by transitions away from coal.¹⁶ More recent multistakeholder approaches, such as the Just Energy Transition Partnerships, represent promising approaches to support the phase-out of fossil fuels through addressing the social consequences.

The introduction of a range of supply chain due diligence regulation, focusing primarily on labour and human rights, has put a spotlight on global supply chains, particularly across Asia. These include policies such as the EU's Corporate Sustainability Due Diligence Directive, the US Uyghur Forced Labour Prevention Act, and the Japanese Ministry of Economy, Trade and Industry's Guidelines on Respecting Human Rights in Responsible Supply Chains (which marks Japan as the first Asian country to introduce such voluntary guidelines). This is a particular risk in Asia, with the International Labour Organization estimating that Asia Pacific accounts for over half of the estimated 27 million people in forced labour globally.¹⁷ Understanding these policies, and the potential risks associated with them, is important for several Asian economies and companies, given their prominent role in global supply chains.

Corporate Governance

Understanding corporate governance is not a new issue for those looking to invest across Asia. However, more recently, we are seeing a growing recognition from regulators of the valuable oversight function of corporate boards, and the importance of having an effective board to fulfil this function and create shareholder value.

For example, China's Securities Regulatory Commission recently introduced 'Measures for the Management of Independent Directors of Listed Companies', designed to create a more systematic approach to ensuring outside directors are truly independent and to provide resources to support them in fulfilling their responsibilities.¹⁸ Japan's Financial Services Agency issued a recent opinion statement and action program to accelerate corporate governance reform, which seeks to overcome some of the country's historic barriers to effective corporate governance, including measures to enhance the capital efficiency of Japanese companies, improve the effectiveness of boards and outside directors, and enhance the quality of dialogue between companies and investors.¹⁹

In pursuit of this, regulators have also looked to enhance board diversity, particularly board gender diversity, with several upcoming deadlines to eliminate single gender boards. We believe this, as well as broader diversity and inclusion efforts, will continue to be a significant topic going forwards in Asia.

¹⁶ IEA (November 2022) Coal in Net Zero Transitions

¹⁷ ILO 2021 Global Estimates of Modern Slavery

¹⁸ Reuters, China issues management measures for independent directors of listed firms

¹⁹ FSA Opinion statement – action program for accelerating corporate governance reform: from form to substance



Key takeaways from PRI in Person

The need for responsible investors to understand and play a role in supporting the low carbon transition, and the emergence of transition finance, came across as a key theme of the conference. This was emphasised during Prime Minister Kishida's keynote speech, where he reiterated the Japanese government's green transformation policies and its plans to issue a ¥20 trillion transition bond to support this. Compared to previous conferences, there was also a noticeable emphasis on the need for a just transition, with several sessions touching on this topic and its implications for investors.

The importance of nature and biodiversity, and the links to climate, were ever present across the agenda. In line with the conference's overall theme of moving from commitments to action, several sessions focused on the practical implications of this theme for institutional investors, including how to understand and get started with the recently finalised Taskforce on Nature-related Financial Disclosures framework. Columbia Threadneedle Investments' Head of Active Ownership, Nina Roth, supported these efforts by speaking on a panel on nature stewardship, sharing our expertise from a history of engaging on this theme.²⁰

The evolving policy landscape in Asia, and the need for regulators to work together to address policy fragmentation, was also discussed several times across the course of the conference.

This was emphasised by the PRI reiterating their call for regulators to adopt mandatory corporate ESG disclosure requirements aligned with the ISSB sustainability standards, by 2025. Growing calls for policy harmonisation across the region will likely be key theme going forwards.

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²⁰ Find out more about our approach to assessing and engaging on biodiversity here.

Our responsible investment efforts in Asia

The conference confirmed the significant appetite for responsible investment in Japan and across Asia. Columbia Threadneedle Investments are committed to continuing our active role in responsible investing across Asia. This is demonstrated through our signatory status to both the Japan and Taiwan Stewardship Codes.

This commitment is more specifically demonstrated through our engagement activities. Between January and the end of September this year, we have had over 360 engagements with Asian companies across a range of material ESG issues. We are also involved in several responsible investment industry initiatives, seeking to enhance ESG disclosures and promote good practices

throughout Asian markets. For example, we are active members of the Asian Corporate Governance Association, being involved in several country working groups, and participating in several company engagements. We are also members of Asia Research & Engagement's energy transition platform, which seeks to engage with Asian companies to understand the risks and opportunities associated with the transition to a low carbon economy in Asia.

As responsible investment gathers speed across the region, we will ensure we continue our active role in this development, focusing on understanding the financially material ESG risks and opportunities on behalf of our clients.

²¹ More information on our stewardship activities can be found in our Stewardship Report 2022

Get to know the author

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Tom joined our Responsible Investment team in 2022. He focuses on research and engagement in emerging markets, focusing on APAC financials and utilities. He previously worked at Impax Asset Management, where he was a Sustainability & ESG analyst, involved in company ESG research and engagement, and prior to that worked within the stewardship team at the Principles for Responsible Investment. He holds a Bachelors degree from the University of Bristol and a Masters from King's College London. He holds the CFA UK Investment Management Certificate.

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