

An aerial photograph of a lush green forest bordering a dark blue lake. A wooden boardwalk leads from a small building with a red car parked nearby towards the water's edge. The scene is captured from a high angle, showing the dense canopy of trees and the calm surface of the water.

**AsianInvestor**

WHITE PAPER

# Investing in a greener future

How asset owners  
in Asia are raising  
the stakes to combat  
climate change

**Driven by a desire to create robust portfolios that also make a positive impact, investors are issuing more mandates and steering greater allocations towards assets that help tackle climate-related risks, finds an exclusive *AsianInvestor* survey.**

The momentum to mitigate the effects of climate change has never been stronger – and asset owners are playing an ever-bigger part in the process.

This is evident by the numbers. According to Morningstar, for example, AUM in sustainable mutual funds and environmental, social and governance (ESG) focused exchange traded funds rose globally by 53% in 2021, to \$2.7 trillion. This was even despite the introduction of stricter rules in Europe around what can be labeled as ‘sustainable’.

Greater ESG engagement is underway generally, such as the move at the start of 2022 by 70 firms, including global investors, to sign up to a UN

treaty advocating a robust policy on plastic pollution.

In Asia, this shift is reflected by heightened considerations about sustainability as part of asset allocation, as well as in the planned exposure to climate investments over the next 12 months.

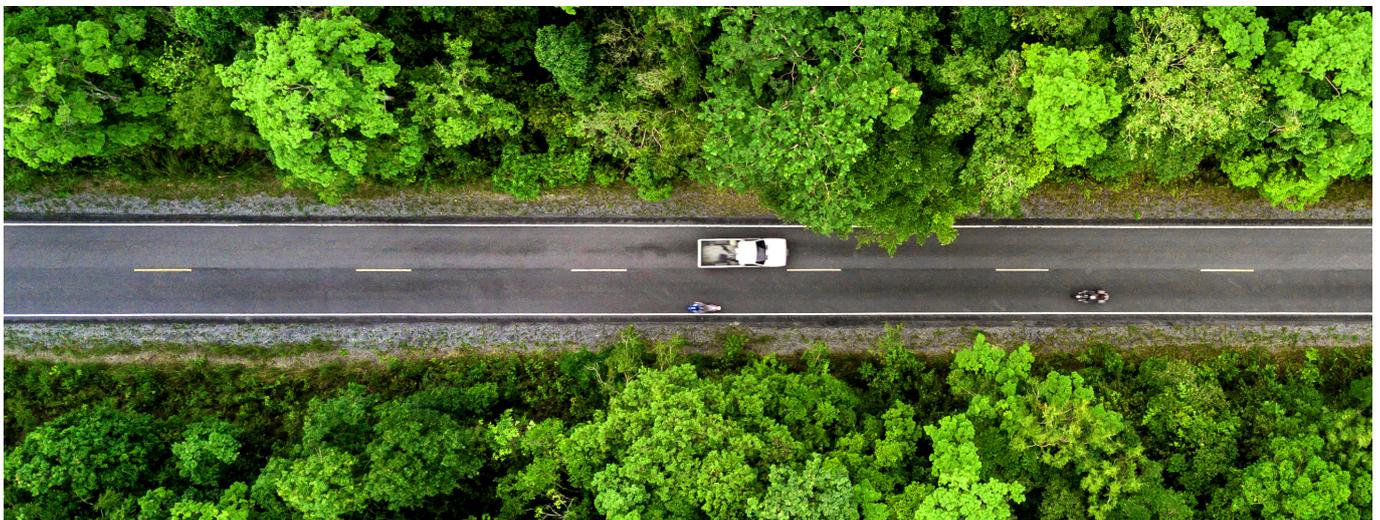
Environmental themes such as clean energy and renewables are front of mind. And instead of efforts to improve returns or outperform the benchmark as the primary focus, long-term portfolio resilience is the main goal. Further, the ESG principles and commitments of external fund managers are almost on par with fund performance when investors select sustainable funds today.

“The momentum to mitigate the effects of climate change has never been stronger”



**\$2.7 TRN**

AUM in sustainable mutual funds and ESG-focused ETFs globally in 2021



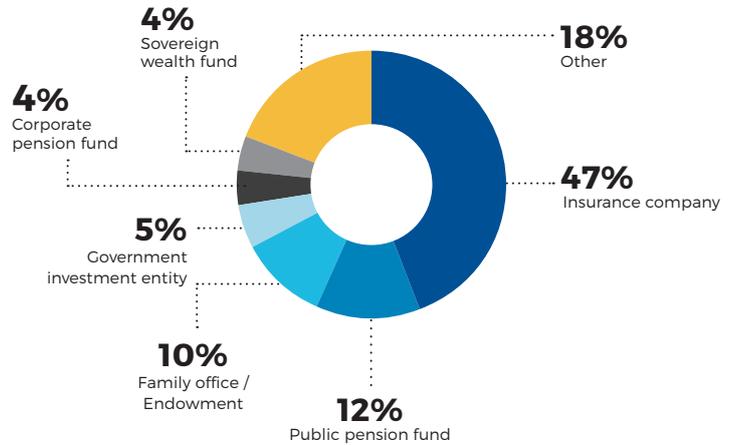
## “Environmental themes such as clean energy and renewables are front of mind”

These and other trends, which show the extent that asset owners in Asia now embrace climate-aligned investing, have been thrust into the spotlight by a regional *AsianInvestor* survey

Conducted between December 2021 and February 2022, it gathered responses from 100 senior investment executives from insurers, pension funds, government entities, sovereign wealth funds, family offices and other institutions across Greater China, South-east Asia, South Korea and India.

### DEMOGRAPHICS

#### Which type of institution do you work for?



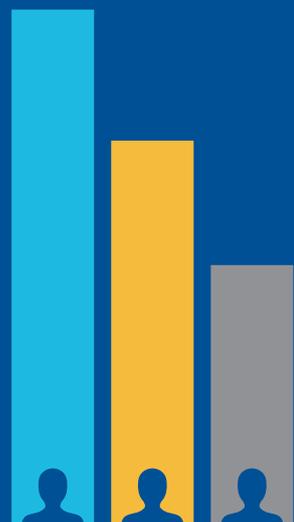
### DEMOGRAPHICS

#### What is your organisation's total AUM globally?



## KEY TAKEAWAYS FROM THE SURVEY

- The environment is still a dominant theme among E, S and G investments
- Climate change is material for asset allocation decisions among 52% of respondents
- Longer-term portfolio resilience is the most common objective when investing in green assets
- ESG principles of external managers are almost as important as fund performance when selecting ESG/sustainable funds
- 31% of respondents prefer passive strategies for climate exposure, while 55% are active
- Clean energy, renewables and storage are overwhelmingly the top climate-related themes
- 70% will boost exposure to climate-related investments over the next 12 months
- More standardised and accurate data on climate-related issues would make the biggest difference in driving more allocations to climate investments – followed by factors such as a wider range of asset choice, and better-defined investment approaches internally



## Counting the climate impact

Perhaps unsurprisingly, the survey pinpointed environmental impacts as the sustainability theme of choice for the majority of organisations.

This stems from the growing climate emergency, explains Richard Chan, Hong Kong chief investment officer, and Asia head of ALM at AXA. “While investors such as us are very focused on the ‘S’ and ‘G’ for human progress, certain topics such as global warming are particularly urgent due to the positive feedback effect.”

The latest report from the Intergovernmental Panel on Climate Change (IPCC), released at the end of February 2022, reinforces this. It issued a dire warning: exceed global warming by 1.5°C, even temporarily, and there will be severe impacts for wellbeing and a healthy planet, some of which will be irreversible.

“If humans delay taking action, then some of the problems might not be possible to rectify,” added Chan.

The attraction of environmental themes is also a symptom of these assets being more quantifiable. “For the time being, the greater amount of government and scientific data available and accessible on the environment encourages investors to focus on the ‘E,’” said Adeline Tan,

wealth business leader for Mercer in Hong Kong.

Many investors seem to broadly agree with this sentiment; for just over half of all survey respondents, climate change is material to their organisation’s asset allocation decisions.

For over a third of investors, meanwhile, the potential impact on climate influences every asset and security they invest in, whereas 40% of them only consider it for certain companies or sectors, such as those in carbon-intensive industries. For many of the rest, there are plans to factor the effect of climate change into investment decisions at some point going forward.

“We are looking to integrate climate considerations into every step of our investment process, including our SAA, risk management and external manager selection,” said Liza Jansen, head of responsible investment at Prudential.



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### CLIMATE CHANGE COMMITMENTS

Which sustainability theme is most important to how your organisation invests?



1

Environmental impacts



2

Governance factors



3

Social considerations

The survey also showed a more patient approach to the capital deployed into green assets.

Rather than a pure focus on performance or alpha, adding longer-term resilience to the investment portfolio is the most important objective for asset owners in Asia overall. However, improving returns or outperforming the benchmark cannot be discounted, featuring as the next priority.

### Focusing on the right theme

As investors engage climate-related themes with these objectives in mind, assets in the clean energy, renewables and energy storage space are by far the most sought after among survey respondents.

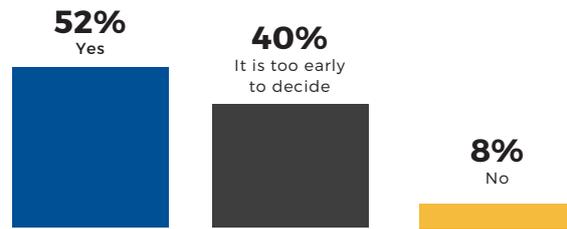
“Clean energy is high on our list,” said Jansen at Prudential. “Asia has very high carbon emissions due to the large reliance on coal for electricity generation, so reducing these needs to start with a switch to more renewable sources of energy.”

In identifying suitable investments, she said Vietnam and Indonesia offer some promising solar and wind farm projects.

For AXA, given its goal to fight global warming, the insurer’s portfolio includes KPIs to reduce the carbon footprint in line with the Science Based Targets initiative (SBTi) from the World Resources Institute.

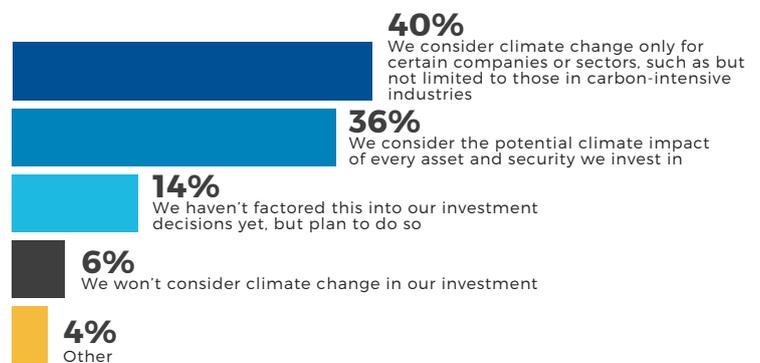
#### CLIMATE CHANGE COMMITMENTS

**Is climate change material to your organisation’s asset allocation decisions?**



#### CLIMATE CHANGE COMMITMENTS

**Which of these best describes the influence of climate change on your organisation’s investment decisions?**



#### CLIMATE INVESTING CONSIDERATIONS

**What are your organisation’s key considerations when investing with a green future in mind?**



In addition to reducing its carbon footprint, AXA also proactively invests in assets that generate a positive impact. “We have a hard commitment on the amount of green assets we invest into, to fund those companies or projects that do good in the world,” said Chan.

When choosing the strategy or investment style for exposure to climate investments, the survey showed investors in Asia to be relatively flexible.

While active fund strategies are the dominant approach, passive strategies – either via thematic ETFs or index-linked funds – are also popular.

For investors to get their preferred climate exposure, Tianyin Cheng, regional head of ESG indices for APAC at S&P Dow Jones Indices, said they are targeting a similar risk and return profile to the broad market index, instead of only performance.

“They are more focused on the climate-related characteristics in the portfolio, leading to requests for a net zero or low carbon version of the index. This makes passive strategies more applicable to these investors, to provide cost efficiency rather alpha.”

The target market seems to dictate the choice of vehicle. “For those markets where we can invest globally, then passive funds can be attractive,” explained Jansen.

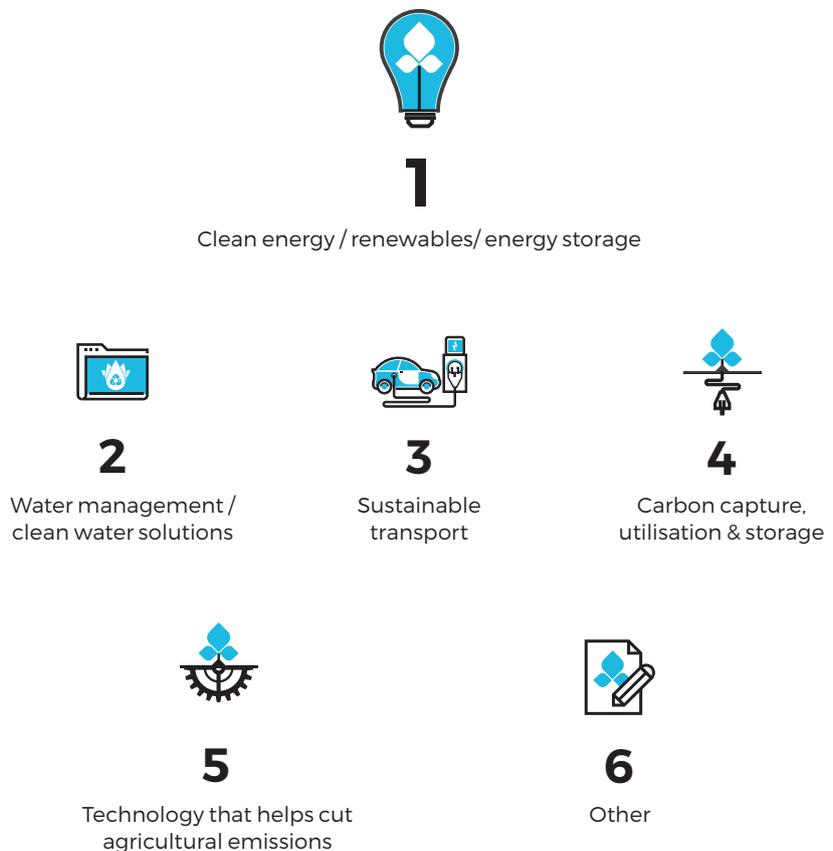
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Richard Chan, Hong Kong chief investment officer, and Asia head of ALM at AXA

CLIMATE INVESTING OUTLOOK

To which climate-related theme will your organisation likely add most exposure to help mitigate climate change?



However, this approach doesn't work for emerging markets (EM), where investors need to be more active. "In general, we would always look to combine our investment strategies with an active ownership approach, through regular engagement and exercising our voting rights."

From S&P Dow Jones Indices' perspective, growing sophistication is expected going forward as investors increasingly look to achieve net zero through a more country-specific lens.

### Taking the fight to the climate

Amid the desire of investors to do well by doing good, implementing climate-related investments is easier said than done.

Indeed, respondents to the survey adopt a variety of approaches – including in-house investment teams conducting due diligence and investing directly (37%), to collaborating with external asset managers (31%), to getting guidance from investment consultants (19%).

At Mercer, for example, the firm uses a sustainability pathway to drive discussions with investors. This helps to determine where they are in their climate investing journey and how they can progress further.

"A hurdle that some investors face, especially with environmental funds, is the

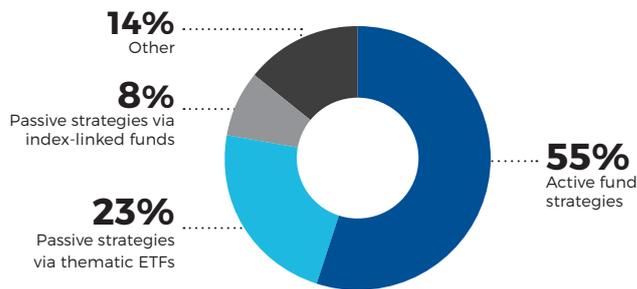
**"For investors to get their preferred climate exposure, they are targeting a similar risk and return profile to the broad market index, instead of only performance"**



Tianyin Cheng, regional head of ESG indices for APAC at S&P Dow Jones

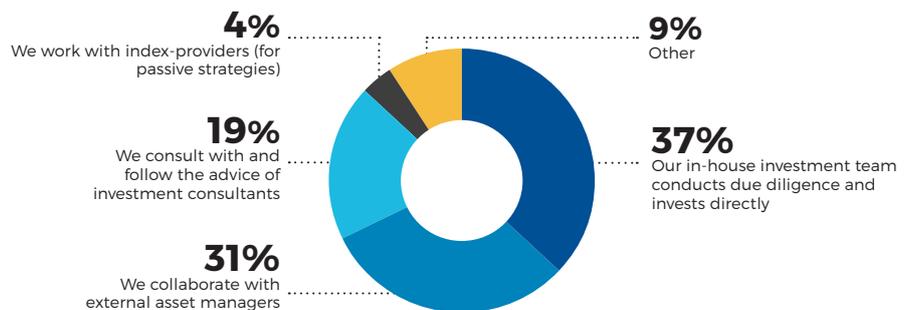
#### CLIMATE INVESTING CONSIDERATIONS

**What is your organisation's preferred vehicle for exposure to climate investments?**



#### CLIMATE INVESTING CONSIDERATIONS

**What is the main way your organisation implements climate-related investments?**



current valuation, given recent performance of stocks that register lower levels of carbon emission such as tech stocks and clean energy assets,” explained Tan. “Many investors are reluctant to the idea of potentially sacrificing good short-term performance to fulfil an ESG target.”

For those investors with a core climate strategy, Cheng at S&P Dow Jones Indices sees them opting for indices or passive funds with a low tracking error compared with the broader market, but which can achieve a good climate outcome.

“There is a lack of strong evidence to show a correlation between ESG or sustainability funds and positive returns,” she explained. “As a result, this creates a mindset among some climate-focused investors to prioritise passive investing.”

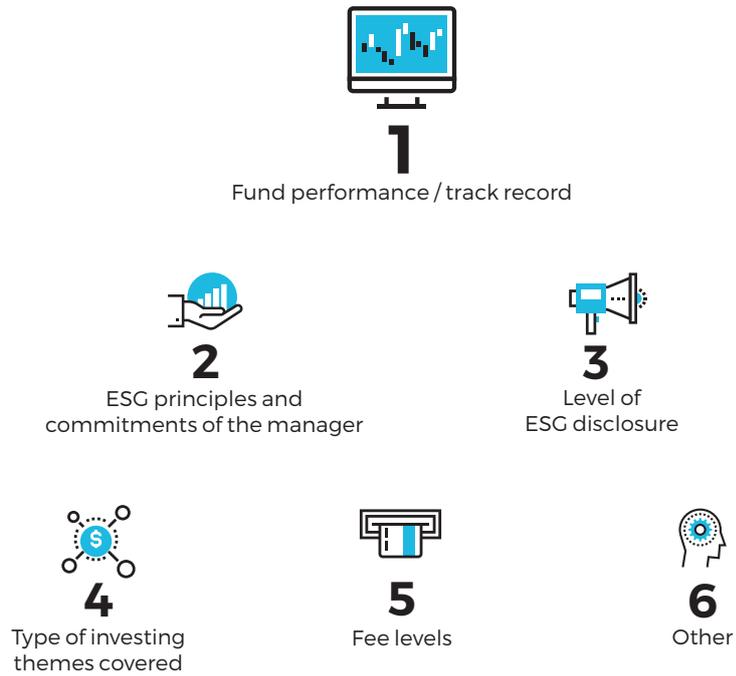
At the same time, there are new ESG and climate index strategies being developed such as factors overlay, dividends and multi-asset, to assist investors to achieve their investment objectives while integrating ESG in their portfolios.

**Sustainability steering fund selection**

Alongside ever-higher inflows into ESG funds is the sharper focus on the ESG principles of the third-party manager, as well as on the level of ESG disclosure available.

CLIMATE INVESTING CONSIDERATIONS

**What does your organisation care the most about ESG/sustainability funds?**



Notably, a fund house’s ESG commitment is only marginally behind fund performance as a consideration for asset owners in Asia, based on survey findings.

“Institutional investors are increasingly looking for exposure to sustainability themes, with a desire for more disclosure from companies,” explained Tan at Mercer. “For some investors, this is due to external pressure from various stakeholders, while for others they say they have always evaluated external managers with ESG considerations in mind.”

ESG is now core to the forward-looking plan for Indonesia’s Haji Financial Management Agency (BPKH).

**“A fund house’s ESG commitment is only marginally behind fund performance as a consideration for asset owners in Asia”**

“As part of our five-year investment plan, all assets we directly invest in will need to be ESG compliant. This means we will avoid any exposure to fossil fuels,” said Hurriyah El Islamy, executive board member.

Fundamentally, this is driven by a priority to focus on the requirements and needs of the pilgrims that the fund represents. “Being the majority owner in assets we invest in means we will be in a position to determine the strategy and direction for the company, to ensure ESG is the priority.”

This underscores increasing awareness among investors of the dangers of greenwashing, according to a study released in late February 2022 by the Asia Investor Group on Climate Change (AIGCC). As a result, they welcome more tools and guidance frameworks to combat it.

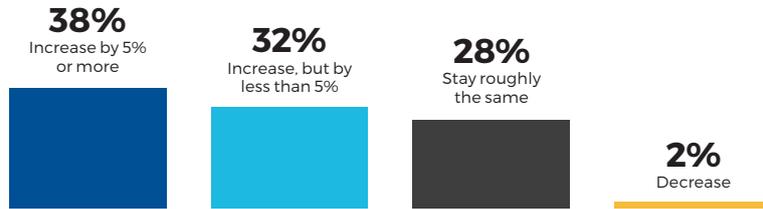
In response, the report said Asian investors are actively embracing new international climate frameworks that enable their portfolio alignment to the Paris Agreement, while also developing further in-house capabilities.

At the same time, the report confirmed that external managers are planning to launch more climate-aligned investment products across asset classes and geographies.

Yet these might need to bear in mind a possibility that the selection criteria investors apply will evolve.

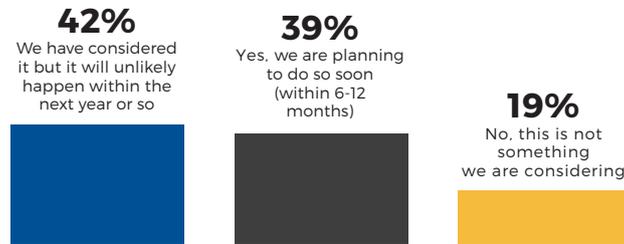
CLIMATE INVESTING OUTLOOK

**How will your organisation’s current exposure to climate investments change over the next 12 months?**



CLIMATE INVESTING OUTLOOK

**Is your organisation planning to issue investment mandates specifically for investing in assets that tackle climate change?**



In Tan’s view, for example, when choosing a green fund, investors need to rethink traditional investment processes such as track record, experience of the team, performance benchmark and fee levels.

“With newer products in the ESG universe, investors need to create the capacity and in-house training to understand market trends, data and returns profiles of various green assets,” she said. “Investors must also be aware of greenwashing by managers who market their funds.”

At BPKH, it is insufficient to select investments that are

“With newer products in the ESG universe, investors need to create the capacity and in-house training to understand market trends, data and returns profiles of various green assets”

simply 'ESG friendly'. "Instead, we need to make an impact by having the power to influence the strategy," said El Islamy.

This will take some time for brownfield investments. For greenfield assets, though, ESG factors need to already be part of the infrastructure to encourage us to invest, she added.

### Making a bigger commitment

The AIGCC study aligns with the overwhelming findings in the *AsianInvestor* survey when it comes to plans by 70% of respondents to increase their allocation to climate investments over the next 12 months.

Many of them have relatively bold ambitions; 38% of total respondents to the *AsianInvestor* survey will increase exposure to green assets by 5% or more.

The role of external managers will play a key part in the process. Nearly 40% of respondents, for example, intend to issue investment mandates specifically for assets that tackle climate change within six to 12 months. And just over 40% have considered such mandates, although it will likely take longer to come to fruition.

The extent of allocations today and in the future will, however, depend to some extent on efforts by the investment community, regulators and other industry

stakeholders to address hurdles that currently curtail climate-related investments to a certain degree.

Greater awareness of the need to combat climate change is not enough on its own. Notable challenges for asset owners in Asia, according to the *AsianInvestor* survey, include: more standardised and accurate data on climate-related issues (31%); a wider range of choices in terms of climate-related assets (28%); and a better defined climate investment strategy internally (24%). Stricter climate-related regulatory requirements are also a key factor for 11% of respondents.

### Setting new standards

A big part of the issue for many investors is the inter-connected need to consider climate investing from an EM perspective. "These countries have specific challenges that

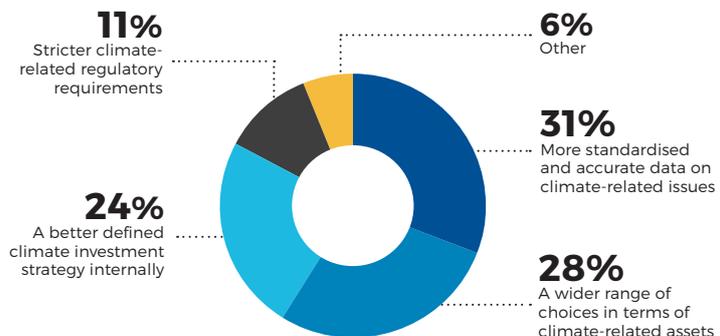


Hurriyah El Islamy, executive board member

"We need to make an impact by having the power to influence the strategy"

#### CLIMATE INVESTING OUTLOOK

**With greater awareness of the need to combat climate change, which of these is most likely to increase your allocations to climate-related investments going forward?**



are not always considered in global standards or frameworks,” said Jansen.

In general, climate policies are created from a developed markets perspective, she added, explaining that applying a common ESG ratings approach to EM doesn’t always fit since companies in developed markets generally have higher ESG ratings, unintentionally shifting assets from emerging to developed markets. “This may defeat the purpose of implementing an inclusive energy transition.”

Internally within institutions, there is also an increasing focus on reflecting stewardship statements in investment strategies.

“This is to ensure the institution is in line with the direction of government policies and regulations in its local market,” added Tan at Mercer.

The *AsianInvestor* survey highlighted this trend. Almost 60% of respondents have adopted a stewardship code, with just under half of those using it to ramp up ESG stewardship; the rest are only looking to maintain existing engagement levels.

Ultimately, without a standardised approach to ESG investing, it is difficult for investors to rely on external data.

At Prudential, the investment team looks to its external investment managers

to create a workable framework to help direct allocation decisions. “We ask these managers to collect ESG data themselves, such as to rate companies,” said Jansen.

AXA would also like to see more global collaboration and standardisation of disclosure in relation to climate-related investments. For example, a common approach to taxonomy would help towards a model for ESG in developing countries, explained Chan. “We also expect the success of climate-related disclosure regulations will be expanded to other areas like biodiversity.”

For the time being, to address the challenges it faces, Prudential is developing a framework to guide its asset managers with a clear and standardised definition of investments that align with the UN SDGs. “This would enable us to increase our allocations to these assets,” explained Jansen. ■

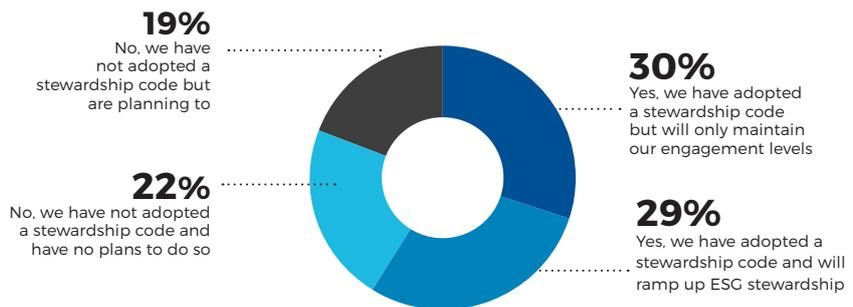


Adeline Tan, wealth business leader for Mercer in Hong Kong

“This focus on reflecting stewardship statements in investment strategies is to ensure the institution is in line with the direction of government policies and regulations in its local market”

CLIMATE INVESTING OUTLOOK

**Has your organisation adopted a stewardship code? Will you exercise your shareholder voting rights more rigorously as part of the ESG ownership actions to fight climate change?**



We really appreciate the contribution of all survey respondents, with special thanks to the various market participants who we interviewed for this white paper.

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