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Responsible Investor/MSCI ESG Research Round Table Report 2016

Stewardship and ESG Integration in the Asia-Pacific region

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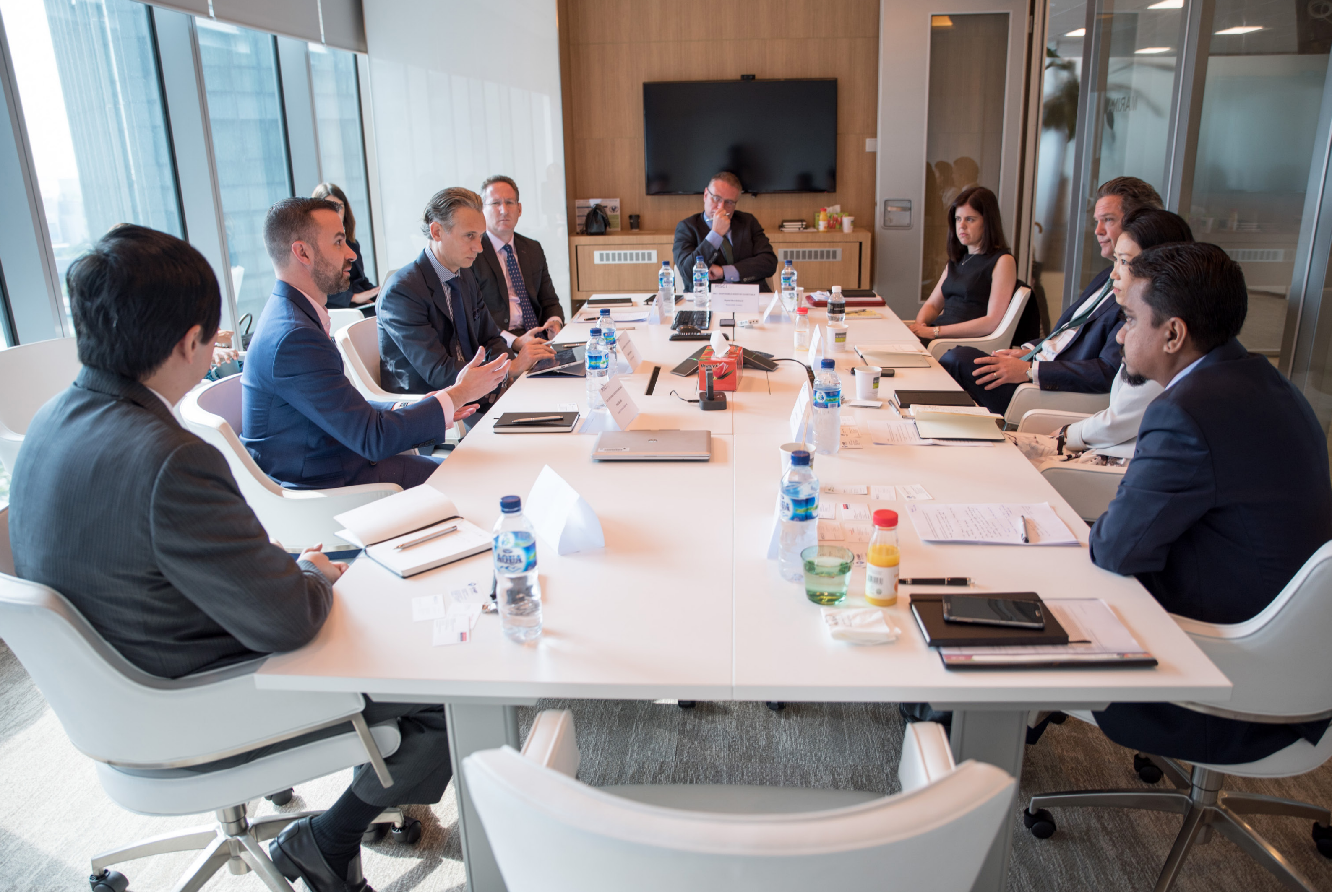


Responsible Investor/MSCI ESG Research Round Table Report 2016

Stewardship and ESG Integration in the Asia-Pacific region

The 5th annual RI/MSCI ESG Research Round Table was held in Singapore on the topic: 'Stewardship and ESG Integration in the Asia-Pacific region. Key blockages and accelerators for greater Stewardship and ESG Integration in the region in comparison to other regions'.

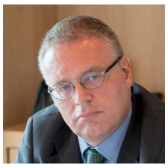
A superb range of speakers took this opportunity to really drill down into this fascinating topic and the insights and expertise shown was truly exceptional. We believe the quality and breadth of this round table discussion reflects not only the importance of the issue – but also the speed the market has evolved.

We hope you find this report stimulating and thought provoking.

Daniel Brooksbank, *Editor, Responsible Investor*

SPEAKERS

Daniel Brooksbank (DB), Responsible Investor (moderator)
Kevin Gibson (KG), CIO Equities, Eastspring Investments
Michael Salvatico (MS), MSCI ESG Research
Pablo Berrutti (PB), Colonial First State Global Asset Management
Linda-Eling Lee (LL), MSCI ESG Research
Kristen Le Mesurier (KLM), AMP Capital
Rizal Mohamed Ali (RA), KWAP
Bill Hartnett (BH), LG Super
Charles Yang (CY), Tokio Marine Asset Management



Daniel Brooksbank: I'm Daniel Brooksbank, the editor of Responsible Investor. I'd like everyone to introduce themselves, and tell us a bit about themselves.

Kevin Gibson: Kevin Gibson, I'm the CIO for Equities at Eastspring Investments, here in Singapore. We have $35 billion in management, primarily investing in Asia, Japan and global emerging markets. We're relatively new on the ESG journey.

Michael Salvatico: Michael Salvatico, Executive Director at MSCI and ESG Research client coverage. I've been with MSCI for five years. Before that I was involved in climate change consulting. Before that, traditional investment management. MSCI is a leading provider of ESG research. We have about 150 analysts globally, from Australia to China. We combine industry research with indexes to provide solutions.

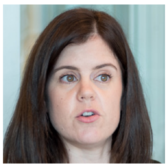
Pablo Berrutti: Pablo Berrutti, First State Investments. We are an Australian based, global asset manager. We manage around $200 billion in assets in listed equities, fixed income and unlisted infrastructure. Our presence in Asia includes Indonesian equities, pan-Asian equities, and Asian fixed income. As an organisation we have had a strong focus on responsible investment and stewardship for over a decade.

Charles Yang: Charles Yang, Tokio Marine Asset Management. I'm a managing director, responsible for international business development and investment management. I was introduced to this topic in 2009, while on the board of the CFA Institute. ESG is quite an important topic.

Rizal Mohammed Ali: Rizal Mohammed Ali from Malaysia, from KWAP. We invest in governments, public sector. Assets are $30 billion. I'm in corporate strategy. Previously, corporate strategy, planning and corporate governance. We're in the process of setting up an ESG unit.

Linda-Eling Lee: I'm Linda-Eling Lee, Head of Research for the ESG group at MSCI, based in New York, even though our analysts are all around the world. Michael has introduced us as one of the leading providers in ESG analysis. We have a deep history of providing analysis. MSCI is an amalgamation of a number of legacy independent providers. Within MSCI, the largest parts of our business are indexes and analytics. We're seeing a lot more integration with ESG. We're working across the firm, providing ESG in different areas.

Bill Hartnett: Bill Hartnett, Local Government Super. I'm the Head of Sustainability. I'm the only asset holder here. It's close to a $10 billion fund, with a strong commitment to responsible investment. My role is quite senior, reporting to the CIO. For each asset class, we want to understand our risk return objectives and then see how we can develop multiple RI strategies – such as negative screens, positive screens or ESG integration – that help achieve the investment objectives.



Kristen Le Mesurier: Kristen Le Mesurier, Senior ESG Analyst at AMP Capital. We manage $160 billion across asset classes. We have large listed equity funds and fixed income funds. ESG is integrated across all of our funds but some funds have specific ethical charters with sustainability at the core of the investment decision. I have been a business journalist with a large media organisation, a litigator, a corporate governance advisor, an equities analyst and more recently an ESG analyst.

DB: The UK Stewardship Code from 2010 states: 'To enhance the quality of engagement between asset managers and companies, to help long-term risk adjusted returns to shareholders'. Bill, is that the correct definition for stewardship?

BH: It's a good one. The whole area we're looking at with investment stewardship, and why it's novel, is this long-term concept. We're investors, but also owners of assets. There are agency issues, short-termism in the financial services industry. The 'service chain' is long, from company proponents through to sell-side bankers then buy side analysts, with consultants and speculators involved throughout. There's the potential for a lot of leakages, and different areas of focus and misalignment. When you put on the lens of stewardship and commence engagement with both asset managers and companies, as the ultimate fiduciary, you will quickly see these short-term actions and misalignment which manifest through suboptimal governance, misallocation of capital and suboptimal returns for our members. It's a chronic issue within financial services. So, it's not a bad definition.

DB: Do you have any data to back it up?

BH: We see it play out regularly in our roles and via the tools we use as stewards such as exclusions, voting, engagement with companies in industry groups. Typically where we see a narrow or short-term view, we see misallocation of capital and a lack of understanding of systemic risks. This behaviour is often fuelled by high-at

Linda-Eling Lee: 'To capture the value being generated from stewardship activities, you need time. Otherwise it's difficult, with an upfront cost, to engage companies. Asset managers will tell us their mandates are too short, and they are being judged on shorter-term performance, which makes it hard to invest now to harvest the value later on'

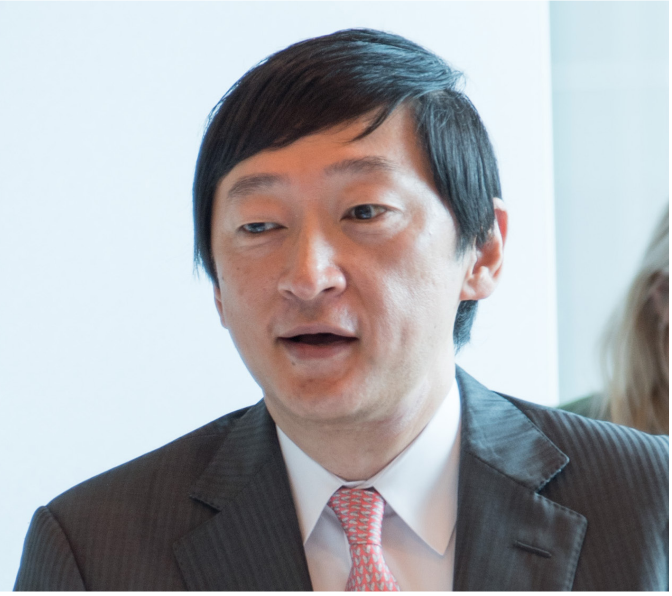
Bill Hartnett: 'Typically where we see a narrow or short-term view, we see misallocation of capital and a lack of understanding of systemic risks. This behaviour is often fuelled by high at-risk remuneration packages. These are often behaviours that are not in the interests of long-term shareholders'

risk remuneration packages. These are often behaviours that are not in the interests of long-term shareholders. With ESG integration, when I see under-performing companies, I can link it to poor decision-making made within the company. That can be linked to short-termism. So you try and improve the practice within the industry, for better long-term return.

DB: Does anyone want to jump in on that?

LL: There's a mismatch between the time horizon of the manager versus the asset owner. The link between ESG integration and stewardship is time horizon. If we think of ESG integration as the incorporation of information that's currently overlooked in valuing an asset today, we think about stewardship as, beyond the current value, what you are doing to protect the future value of the asset by mitigating the risks that might materialise to damage that value. In order to capture the value being generated from stewardship activities, however, you need time. Otherwise it's difficult, with an upfront cost, to engage companies. Asset managers will tell us their mandates are too short, and they are being judged on shorter-term performance, which makes it hard to invest now to harvest the value later on.

RA: In Malaysia, stewardship has been around for longer than ESG integration. ESG integration is a new area the Malaysian institutional investors are actively looking into. At the corporate level, ESG integration involves more ownership by different departments. In Asia, from



Charles Yang: 'Japan has come a long way in terms of stewardship and corporate governance. Now, at least people are aware of the words 'ESG, stewardship, integration, corporate governance'. You look at the cost for companies. Most asset managers and owners think it's going to be a tough battle'

Pablo Berrutti: 'Stewardship and ESG integration have grown because of the recognition globally of the need to move towards more sustainable development. We don't really have a choice because challenges like climate change, economic stagnation and population growth are interconnected and impossible for institutional scale investors to avoid'

what I see, investors are actively seeking the best way to conduct proper integration. We use recommended best practice, and base our own ESG framework and stewardship policies on that.

CY: Japan has come a long way in terms of stewardship and corporate governance. Now, at least people are aware of the words 'ESG, stewardship, integration, corporate governance'. You look at the cost for companies. Most asset managers and owners think it's going to be a tough battle. Could ESG be really integrated into the fabric of your organisation? That's a challenge many still have.

DB: The Japanese situation is very much top-down?

CY: Yes, top-down. That's why people at least want to learn more about it. The awareness is rising but appreciation is still relatively low. Over time, you want it to go bottom-up as well. It has to go beyond ESG as something that is of benefit to asset owners only. We are still working on that link.

PB: Stewardship and ESG integration have grown because of the recognition globally of the need to move towards more sustainable development. We don't really have a choice because challenges like climate change, economic stagnation and population growth are interconnected and impossible for institutional scale investors to avoid.

A long-term focus is important, but to be successful with a more sustainable development approach, the investment community must be able to deliver value for multiple stakeholders – it's about protecting our licence to operate and avoiding the diminishing returns which occur when issues like these begin to bite.

If you look at the global financial crisis as an example, it is clear that a lack of stewardship and responsibility were at its heart. It resulted in an event which almost sunk the global economy. Society won't tolerate a financial industry that continues to operate that way. That's the key challenge. How do we continue to create good-quality products that deliver value over the long run, but in a way that's more sustainable?

DB: Kristen, from your background?

KLM: I think the terms 'stewardship' and 'ESG integration' really depend on the context. Stewardship is more relevant for passive managers with a long-term investment horizon who elect to manage money responsibly and typically attempt to achieve that with engagement. In that context, stewardship tends to refer to engagement.

For active managers, stewardship is part of ESG integration and tends to reflect a commitment to invest for the long term. We need to be careful with both terms though, the risk is that it's easy for funds to say that they take stewardship seriously and that they integrate ESG but both are difficult to do in practice.

To properly integrate ESG, you really need to dig deep

Michael Salvatico: 'We're getting to the point where investors are seeing some tools available in the marketplace, and ways to use those tools to measure engagement. For instance, a lot of ESG integration is about researching companies and sectors and exposures'

when you analyse ESG issues and ask the 'So what?' question constantly – i.e. what does this ESG issue mean for the long-term sustainability of earnings for a stock and an industry. I think one of the risks with stewardship is that it's easy to say but hard to do. It's particularly difficult for passive managers.

DB: What are you measuring, when you say, 'We do stewardship'?

MS: Great question. Is your activity demonstrating an outcome? It would be more beneficial if you presented your board with, 'Our stewardship has resulted in these outcomes.' In terms of overall portfolio exposure, or individual companies' behaviour. We're getting to the point where investors are seeing some tools available in the marketplace, and ways to use those tools to measure engagement. For instance, a lot of ESG integration is about researching companies and sectors and exposures. Likewise with what Kristen mentioned. One of the key areas of research we provide is management of material and key issues, which comes up to an ESG rating. Investors can use that report to identify where they're exposed, through their investment in a company, to a particular area. It might be a particular indicator they want to see across companies. If they see companies aren't reporting on it, they engage with them, see results in the next update of that ESG ratings report. That's evidence that stewardship has led to a result.

DB: How many sectors are doing that?

KG: Our industry is chronic for its lack of transparency. It really comes down to, if you're being a steward, you have to be a trusted partner. There's an element of free ride stewardship. Some people really put their shoulder to the millstone and take their responsibilities seriously. Others don't. Our industry thinks it's okay to report on its top 10 investments, yet an asset owner might have several thousand investments. We're not an industry that are very engaged around trust and development. Stewardship is still a long way away from the realm of most people in financial services.

CY: The question you get all the time is, 'How do you do attributions on your performance?' You struggle to answer that question. I don't know how to separate out the different attributions. People may feel you're trying to hide something.

KG: We've got to bury this notion of 'It's long-term.' It doesn't help us. The more conventional way of short-term, transactional investments is leading to negative outcomes. We haven't started this today. It is long term, but it started a long time ago. For example, the decisions that Volkswagen made, and the extreme problems the company has now, started a long time ago. They just manifest themselves now as some sort of scandal. Take the Global Financial Crisis: if you look closely, the roots go back a long time before 2008.

MS: The buck stops here. We're almost held to account for the financial crisis, for not showing stewardship at the time. There are no penalties for not doing it.

Kevin Gibson: 'Our industry is chronic for its lack of transparency. It really comes down to, if you're being a steward, you have to be a trusted partner. There's an element of free ride stewardship. Some people really put their shoulder to the millstone and take their responsibilities seriously. Others don't'

Rizal Mohamed Ali: 'Can one argue that a company can perform stewardship duties well without ESG integration? If you're just bringing ESG integration, it doesn't mean you fulfill your stewardship roles. ESG integration is not a full process that you can fall back onto'

DB: Rizal – do you have a take on this?

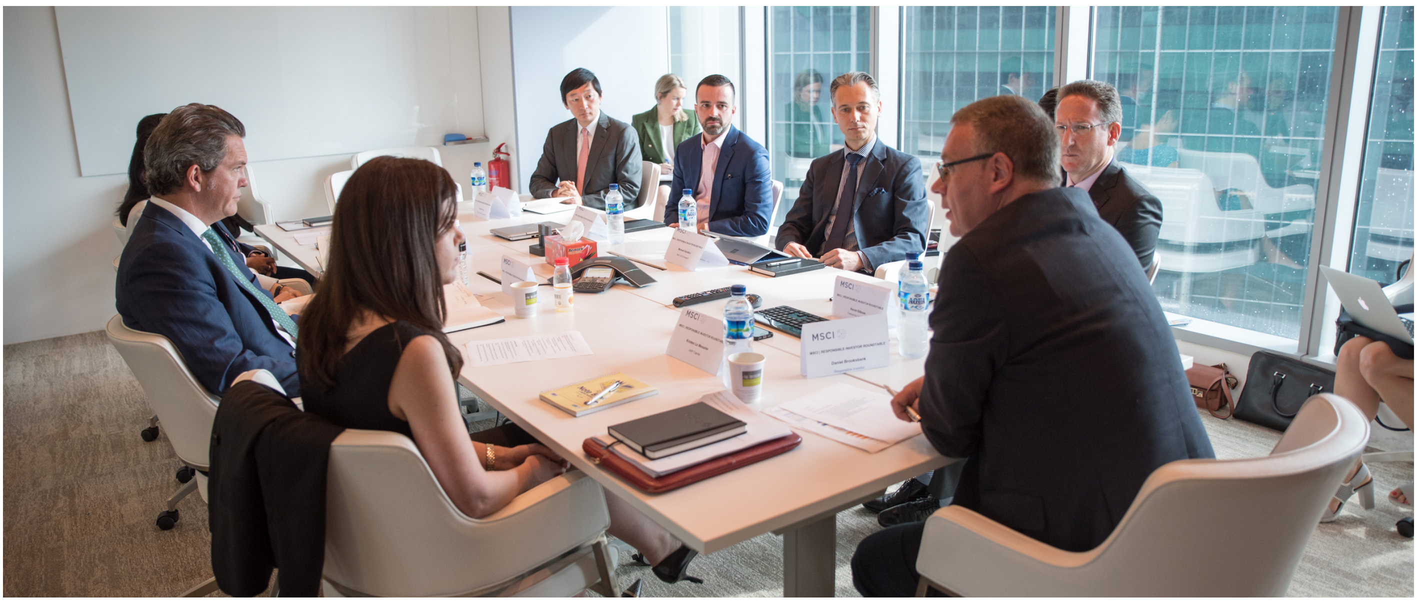
RA: When you say there's not a benefit ... a lot of money was lost. To backtrack, I appreciate your ideas on the question of how ESG is different from stewardship. Can one argue that a company can perform stewardship duties well without ESG integration? If you're just bringing ESG integration, it doesn't mean you fulfill your stewardship roles. ESG integration is not a full process that you can fall back onto. That's the main difference. Most organisations, certainly most institutional investors, have stewardship in place, but not all have ESG integration.

MS: I totally agree. The point here is, ESG is about understanding risk. Investors need to change how they look at companies to capture the risks. You combine ESG research analysis with traditional analysis. It reminds me of a conversation I had with my manager at Merrill Lynch. We were looking at the right company to buy. I was told what I was looking at was a good company. The aim was to find good stock, not good companies. That made me think. It means you're just after a ticker that has a good chance of improving in the short term. That's the focus that needs to change. It's not just about finding a good stock, it's about finding, or making, a good company.

PB: Without the sense of owning the impacts and having responsibility that comes with a strong sense of stewardship, ESG factors can be used very cynically, particularly in the short run. A good stewardship approach should lead to a desire to invest in businesses which have a productive purpose, genuine value creation as opposed to what will make money in the short run on the back of negative externalities.

In terms of measuring stewardship, the amount you churn your portfolio will impact on whether you can be an effective steward. So one measure could be how many of the companies you hold now did you hold five years ago, and the annualised rate of turnover over that period. Used together these two measures can provide an insight into stewardship and engagement potential. For asset owners who want to create long-term value, it's reasonable to question whether managers who have high turnover and low name retention are really aligned.

LL: Turnover is not typically part of the investment mandate. Therefore, you can keep turning over the portfolio. When we do an attribution analysis of a portfolio's returns, if you're taking a one-year timeframe, a lot of the return in any given year can be attributed to changes in valuation. But over 20 years, what explains the returns



Kristen Le Mesurier: 'I met with a company in the gaming space last week and management was pleasantly surprised by the honest conversation we had about our concerns about responsible gaming. They aren't used to dealing with ESG analysts because they are typically excluded from ESG funds but they were genuinely interested in how we look at the world, how we assess risk and the issues we would like addressed'

over that longer timeframe is the ability of the holdings to generate and grow cash flow – so you can see that in dividend growth and yield capturing the largest share of what explains long term returns. We did a piece of analysis for the Ministry of Finance in Norway that shows exactly this. If you're a long-term asset owner, you shouldn't focus on year to year valuation change, but as a manager, to maximise year to year returns, of course you are paying attention to fluctuations in valuation.

CY: How do you get an asset owner to think long term?

LL: There are mismatches all along the trail. It's not a one-link problem.

CY: There are a number of points I want to come back on. Quality versus value, good companies, that's a subjective assessment. It changes over time, correlated with price. The nature of the industry, client demands, etc. It's up to us, as asset managers, to get the communication right with clients. We're looking to deliver performance over a three-year period, over whatever benchmark you care to measure us against. We don't necessarily believe in a particular index as a benchmark. We have to get that message across and manage expectations.

BH: I'd also take issue with some points. One of the good things about being a listed market investor is its liquidity, you can sell stocks. You can also vote against a company at its AGM. So we do not need to just hold hands indefinitely with the company over an ESG issue if it is causing loss of shareholder value.

PB: If you want to deliver long-term value through stewardship, you won't do that over six months, without building a relationship with the management, which takes years in many instances. You're right, there are some companies which should be uninvestable, because you can't measure the risk. You could argue that you can't measure the risk to a tobacco company with thousands of ongoing and pending litigations. How do you quantify that? However, there are a lot of companies who, with the right type of patient and respectful engagement, will make positive changes.

DB: Kristen, do you have a take on that?

KLM: I agree, although while some sectors and stocks are excluded from AMP Capital's responsible investment funds because their business models are ultimately unsustainable – for example, tobacco and gaming where the externalities are borne by society or governments – we are still very active in engaging with those industries. I still meet with management to raise ESG concerns and I'm able to do that because of our investments in those companies in non-ESG funds.

DB: How do the companies react?

KLM: It's mixed. I met with a company in the gaming space last week and management was pleasantly surprised by the honest conversation we had about our concerns about responsible gaming. They aren't used to dealing with ESG analysts because they are typically excluded from ESG funds but they were genuinely interested in how we look at the world, how we assess risk and the issues we would like addressed. I think there is an ability to drive some change notwithstanding the issues we have with their business model. The next time we see them the conversation is likely to be more productive.

BH: The hostile response can often be a good indicator about how seriously companies take stewardship, sustainability and responsibility. We've had plenty that have been hostile on some ESG issue. This has often proved to be a strong forward indicator on share price performance as the companies have struggled. Often companies misunderstand that society has expectations well above minimum legislative requirements. Stakeholder management is difficult to deal with and most executives didn't learn it at MBA school.

RA: I feel that institutional investors are in a good position to make improvements for the benefit of our nation, because of our long-term investment horizon. Compared to asset managers, we can have longer-term engagement.

My point is, we do sometimes conduct long-term engagements and try to give them more time and resources before we decide.

DB: It's voice over exit. If you're not at the table, you don't have a voice?

RA: They can still engage.

PB: There's a multiplicity of approaches, no 'one size fits all'. There are lots of ways to combine ESG integration and stewardship that will deliver different outcomes depending on the type of investor. It's not voice vs exit, both approaches are legitimate in different circumstances. The comment Charles made about being asked to attribute the value add of ESG is interesting in this regard.

Judgment and prudence come into play as an active investor. How do different measures support that? There are things that can and should be measured and we should be evolving that, but I think we spend too much time talking about how to measure the financial effectiveness of engagement. It should be enough to say that we engage with companies because our fiduciary duty is to invest with due care and diligence. We can then focus on a mix of measures and case studies to show we are doing it well and learn lessons from when we don't.

Different approaches will work with different companies and we should also accept that sometimes it's not worth it, in which case you have to make an informed decision about risking clients' capital. There will also be situations where engagement has been unsuccessful and selling is the most prudent thing to do.

KG: Following on from that, I was going to put it out there, clearly people's interpretation of ESG integration is very different. We're very early on our responsible investment journey. We started about a year ago. We're primarily Asian-based in terms of clients and assets and investment. We've made great strides, but we're not there yet. From the outset, our approach has been 'investment centred' and we have been cognisant that RI and ESG are not a simple 'package' that can be transplanted from one institution to another. Furthermore we have made a conscious decision to not rush in and sign up to the PRI, just so we can tick a box and achieve a 'quick fix'.

Rather, we made a conscious decision, 'We're going to do it properly, with the best intentions, and become part of the investment solution, investment-centric rather than marketing-led.' We found we were assessing ESG risks implicitly in our investment process. What we try and do is to understand the returns a business can generate on a sustainable basis. ESG is central to that. Whether it's poor employment policy or bad environment record, it will impact on returns. We try to quantify that. I take your point around tobacco. We would say if that is too difficult and hard to quantify the risks, then we'd walk away, but it wouldn't stop us investing in uncomfortable parts of a business if we think that a company can generate returns on a sustainable basis. We will not negatively screen companies out, but it's a flag that impacts returns.

PB: Many active managers do it implicitly. There are things they're not comfortable with. It may be the type of business, or the way the business is run.

In Asia, Japan is a good example of where we are seeing positive change. It was difficult to engage with companies for a long time, but now we're seeing the odd independent director appear on Japanese boards, and there's willingness for greater levels of engagement. We should celebrate that.

CY: Absolutely. My background includes Japanese equities and asset management organisations in Japan. I've been through a lot of angst, but even prior, there was a realisation by Japanese corporations that change needed to happen.

LL: I have some numbers from the data verification process we conduct in our research that indicate more Japanese companies are becoming aware of these issues. Across the global universe of companies we cover, we send every single company we analyse the data we have collected that are inputs into our ESG assessments. And every single company can access their own reports that we write on them. We don't do surveys of companies for our analysis. It's completely on a voluntary basis that companies contact us. They ask questions about their assessments, and they give us feedback on how they change the way they report, and so forth. We typically get much higher inbound communication from developed versus emerging markets. For companies on the MSCI World Index, 30% of the companies contact us.

DB: How has that changed?

LL: There's definitely an increase, but it differs by region. 35% of European companies will contact us. In Asia, only half that, including Australian companies. As for the Japanese companies, two years ago we got a 12% response rate. Last year, that had doubled to about 23%, 24%. Just last week, I looked at our first half numbers, and the Japanese companies, if we extrapolate the first half, it would be above 30%, closer to European numbers. One in three Japanese companies we send data to are coming back for more information.

CY: Yes, the top-down. I won't say that's the easy part, but it's the next step that is important. It's the bottom-up issue. The top-down message, now how does that become part of the fabric of the organisation? That's the difficult part.

MS: That increase in response rate is a demonstration of an implicit form of engagement. They realise it's important to investors. They see implicit motivation to be better in ESG exposure, through indexes, which exclude poor-behaving companies. Companies start to listen when you threaten their access to capital. I also wanted to talk about differences between two major styles of integration. We kind of covered it already, but to highlight it, there is a focus, that the origins of ESG research is around accepting a company based on its business involvement, and excluding companies which don't have your investment values. You see this in Malaysia, we talked about tobacco exclusion. One area where it's been on my radar is New Zealand. There's media attention. This is one driver of stewardship, and Charles touched on it, around country expectations and cultures. In New Zealand, they don't invest in cluster munitions. It's legislative.

PB: The thing about the New Zealand media over the past couple of weeks is, people who are invested in a default option haven't made an active decision to do that. The argument in New Zealand is, should that option reflect community standards and expectations around what should be in those investment options? It's never been framed that way before, as to what extent should pooled investments reflect these expectations and standards, and to what extent can we measure them?

MS: This is where it comes down to asset managers being accountable. In Australia, they are very much accountable. New Zealand Super has overseas managers who don't spend their life studying New Zealand legislation. It's the responsibility of the asset owners. Around the value side of things, it might also be the business' behaviour. To tie that back to Bill's comment, exclusion is a form of investing and potentially making your views known. New Zealand Super have excluded a couple of companies. They were quite public about it. Part of that was through assessment of their controversies, assisted by research we provided them. The other area of integration is around understanding material exposure that you have, as an investor. That's where the majority of investors are focused. MSCI have 47 out of the top 50 global asset managers using our research. They're not all ethical investors, but they're concerned about material exposures.

BH: We use exclusions. But around every board table of every asset owner is a big ball of string around values. 'Do I divest in tobacco? Do I look at carbon, gambling?' There's no right or wrong answer, but very few asset owners have had discussions around this. I think the trend towards exclusions will get stronger with the increasing drive on transparency and further development of 'Who is the fiduciary? Whose money are we investing?'. We've seen it with fossil fuel divestments over the last while.

We had a discussion recently in our investment committee about tobacco. Tobacco stocks make a lot of money: They're a great investment. How can you avoid investing in them? There are a couple of answers. You can get surrogates for tobacco and then we tend to forget that we invest in highly diversified portfolios and this diversification itself provides performance benefits. However you do not need to be in every single sector to get the full benefits of diversification. LGS has been out of tobacco for 15 years. At the end of the day we go back to our investment objectives – in equities we adopt an active approach looking for some excess returns over a benchmark for a set level of active risk. We have comfortably achieved this objective for several years without being in tobacco (and armaments, gambling, nuclear and some high carbon sectors).

KLM: When CalPERS announced recently that they had lost significant returns in the short term by excluding tobacco, that generated a lot of discussion in the investment industry generally. We have been challenged by fund managers asking: 'what returns are we missing out on?' But the reality is that this is one of those timeframe mismatches we have been discussing – ethical values aside, tobacco is clearly not an industry with a sustainable business model in the long term. The externalities are currently borne by society and governments. It makes financial sense in the long term to exclude tobacco.

Then, consider the ethical layer. A number of investors will choose not to invest in that kind of a company and they will put their money where their mouth is: that they are prepared to disregard the return in the short term. Of course it's difficult when stocks that have been excluded because of the long term perform strongly in the short term but that's why responsible investment funds are very clear about the investment mandate. It would be helpful for fund managers to have more contact with the people

whose money they are managing, to the end member. That contact rarely happens in investment management. Fund managers tend to sit in high-rise glass offices, far removed from the people whose money we are managing.

At the moment, tobacco highlights the tension between the easy short-term return and the 'right' return for the long run. Unfortunately, tobacco has given fuel to the old adage that you are sacrificing returns by investing money responsibly.

MS: It doesn't mean foregoing returns, but you're right, there are lots of ways to make money. As an investment manager, you've got a style, and you don't invest in certain things because they don't meet your style.

KLM: Yes, but ESG investors do need to be proactive and continually prove the value over the long run, that's just the reality. So we have a hypothetical, index-based ESG model fund that is quite restrictive – it excludes about one third of the ASX200 on ESG grounds, and we track the performance over time. So we can pull that out at any time and say this is our ESG universe and we believe it gives you a better investment universe over time. If you invest in these stocks over the long run the returns are superior.

MS: I show people that stocks with ESG factors outperform, but they look at me sceptically.

KG: Asia is ground zero for the future of the planet. The development challenges that exist, issues around resources, carbon and so on, are enormous. It's a big exporting part of the world. We see palm oil as a good example of how customers of Asian companies are holding them to higher standards now. As it's such a diverse market, it's not homogenous, that each country has its own unique characteristics. There's an opportunity for a good quality active manager to come in and find good Asian companies that deliver sustainable returns. There was a recent meta study of 2,000 different academic pieces of research which found a strong relationship between ESG and superior investment performance. Breaking down by market, they found that in the more developed markets like Europe, you didn't see the same return benefit that you saw in markets where ESG is less developed. That seems weird, but the companies that are doing it well in the lower standard markets are delivering greater benefits over the long run. You see markets in China for example where ESG is happening at varying levels. There are problematic government issues, but they also delivered half the green bonds last year. This is a great opportunity for investors who want to get at that sustainability theme and achieve good returns.

LL: Some of our analysis has shown the correlation with returns. When we tilted a portfolio towards higher ESG rated companies, we saw some evidence of outperformance. We have seen that as well when applying our own ESG rating to indexes for developed versus emerging markets. The emerging markets indexes tilted towards better ESG ratings have demonstrated sizable outperformance in the last couple of years, even more so than for developed markets.

PB: The disclosure standards are lower. In South Africa, mining companies have horrendous safety records, but they look okay on an ESG rating because the disclosure standards are higher which masks some of the poor performers. In countries with lower standards the genuine companies can distinguish themselves more easily. I'm not suggesting we keep standards lower, but it's where the greatest opportunities lie.

MS: During my days at Merrill as an emerging markets strategist, we looked at Asia. It was about momentum. Less about building better companies. That was many years ago, and has that changed? Is that pressure still there from asset owners that Asia is about the more speculative end of investing, and therefore ESG matters less?

KG: I think we've got a long way to go. We had our first formal engagement with a company that I won't name. We formally wrote a letter to a company with a questionable third party transaction. I like to think it was because of that letter they stopped that transaction. That was gratifying. We've got other investors on board as well. That was interesting, but we've got a long way to go.

MS: That's where the opportunity lies. You've got your tick-box approach to corporate governance: an independent board, chairman and CEO. That's all fine, but some companies that have family ownership, or longer-term stewardship mentality than some boards in the US, for example, it's their treatment of minority investors that becomes the problem. We spend a lot of time making sure companies won't abuse our rights as minority shareholders in the future.

CY: Going back to Japan. There was a company that I won't name with a questionable corporate governance history. They had 'certain targets' for management, and it was eye-opening. We got in touch with them, saying: 'Let's have a meeting.'

DB: That was a signal for you?

CY: Yes, that triggered our interest, to go and visit them. What we read was real, the change of management attitude, the way they managed the business.

KLM: There's been a huge improvement with Asian companies over the past five years. In some countries more than others, of course.

DB: What's driving that? Is that down to the stewardship code, or regulation?

RA: We look at not just investments, but diversity. My observation is that we now realise the influence institutional investors have. Companies place more importance on our questions. A large shareholding makes a difference. They're really addressing our questions and realising that you can now see the financial impact of ESG, that it's as important as your financial performance and productivity.

BH: From an asset owner perspective, a lot of opportunities and risks are magnified in Asia. You can either invest in emerging market-type strategies, or in international companies that are getting revenues from emerging markets. With the volatility of emerging markets in recent times, we could argue there were ESG issues – especially G – as the root cause. Investors must ensure there are good standards.

MS: It's really important to emphasise that ESG is about the 'E' the 'S' and the 'G'. It's a false trap for investors to be comforted by their stewardship, thinking the focus is just on the 'G'. The 'E' and 'S' is less understood, harder to attribute material drivers to, risk-wise. All that's changed. There's been massive investment in understanding the risk. As an investor, in terms of good stewardship, it's about encouraging the companies to improve their governance and environmental and social exposure.

RA: One more point on that. Why is there more engagement now? For investors in Asia, it's facilitated by the respective countries coming up with their own investor codes.

DB: Looking at the impact of things like the stewardship code, why doesn't Australia have one if Malaysia has one?

BH: That's a good thing to import. There are practices you wouldn't want to import, like some remuneration structures. Countries in Asia have an opportunity to learn lessons from other markets that have led to poor outcomes for investors and the broader economy. The stewardship code is good, to set clear responsibilities.

CY: I didn't know Australia did not have a stewardship code. Maybe you don't need it because it's so much part of your daily activity. You need to force that change in a place like Japan.

DB: It comes back to the context, the market?

PB: There is recognition in Australia that it's useful, and we took the broader view that the UK model is mostly externally-facing, with the exception of conflicts of interests. Whereas, stewardship in the sense of looking after your clients' capital also relates to your internal governance. Conflict of interest is important, but also how you allocate trade, manage brokerage relationships, all of this is important. The Australian path will be a bit differentiated in that respect.

KG: Australia also has these corporate governance principles, which have been pretty effective: the 'if not, why not,' ideas around disclosure, which seem to have done a reasonable job.

MS: Australia's had a good culture and history. As well as what the stock exchange have done since 2003, they're in the third edition of the governance code. The Financial Services Council put out a proxy voting standard in 2003. They're about to amend and enhance that. Australia has strong governance, and is a leader in stewardship and there are strong industry bodies. We've had strong leaders in the industry who've helped people understand the integration and stewardship.

RA: I see in the institutional investor working groups, we are aware of where the funds are, in terms of ESG, but when I do research, there are a lot of ESG initiatives in Asia. Even without a stewardship code, Australia's pension fund, you guys have done a lot, especially on the environmental side. I would not say not having a stewardship code is an indicator of lack of ESG or stewardship in the region.

KLM: Australia emerged relatively unscathed from the Global Financial Crisis and I think that had a really big impact. There wasn't the impetus to codify any of those responsibilities in a stewardship code. I think most Australian asset owners and managers have assumed we are already quite advanced when it comes to stewardship but in one sense that is quite arrogant.

PB: We've got great coverage, but it's hard to say how deeply we actually do it. There are material areas where we can improve. There's been an immense amount of hiring by asset owners over the last six months. We will get another big push in the Australian market. We have achieved a lot in a decade and should recognise that, but we're a long way off where we can and should be.

DB: Canada's interesting. I'm thinking of the Canada Pension Plan's long-termism project. They don't have a formal stewardship code.

BH: Canada and Australia are two examples of countries that came out very well from the Global Financial Crisis. We're well positioned, but I would put a bit of a plug in for

ACSI in Australia, a group I'm involved in, the Australian Council of Superannuation Investors. It's an example of what you could do in terms of industry collaboration: this is 35 of 40 super funds representing $400 billion. It's doing lots of work on infrastructure-type investments, proxy voting, guidelines for super funds, remuneration, board structures, capital raisings etc. We're very vocal if there are capital raisings diluting shareholders.

We're strong on remuneration policies. We have a two-strike rule in Australia. If a board gets more than a 25% vote against it two years in succession on its remuneration reports, there is a separate vote as to whether the board be spilled.

It's interesting when you have a bit of carrot and stick. That's been quite effective. We have seen some moderation of remuneration practices. So there are different tools you can use to demonstrate the long-term interests of members in superannuation funds. We'd be open to seeing a stewardship code coming along.

MS: Another big difference in Australia: MSCI did a global survey of best practice asset owner integration and stewardship, and found that global best practice includes having an ESG person in charge of the stewardship and ESG integration.

DB: Collaboration is quite interesting around stewardship. How important are bodies like the PRI and others?

BH: I talked before about a ball of string. It can get very big and long, and groups like PRI can be handy for areas of common consensus, where we see shortcomings within the financial services sector. There continue to be more issues raised. PRI, ACSI, the investor groups do good jobs, but in the end it's the fund's reputation that's on the line. If you have somebody getting a lot of emails saying, 'Divest from this,' or, 'what's your position on that?' funds can't always rely on international third party groups to give them the response.

LL: On climate-related issues, we're finding that many asset owners find it useful to be able to target specific issues where you can move the market average when it comes to climate disclosure and strategy. Asset owners and the large asset managers are trying to move up a particular standard for the whole market, not just for one or two players. Exxon gets all the headlines, but to ask for disclosure around carbon risk for companies in the sector is more important. It's a signal from the investor community that can change market-wide practice.

PB: That's an important point, if you're an asset owner investing across the economy. We've got great collaborative initiatives, but asset owners and managers are still not on the same page. Asset owners aren't setting clear enough expectations for their managers. In Australia, asset owners are generally engaging with companies at a board level, while asset managers speak more with CEOs and CIOs. We don't talk to each other at all. We're talking to companies about the same block of shares, and more cynical companies can ignore both, while ones that are looking to improve are confused that different issues are being brought up at different levels of the investment chain. If asset owners set much clearer expectations of asset managers and asset managers collaborated more with asset owners that will make a big difference.

LL: The feedback we've gotten from asset managers is about the quality of the dialogue with asset owners. When the asset owner can look at a portfolio and say, 'Explain your thinking in terms of investing in this company, and these are the risks we're interested in,' from the manager's perspective, it's a good way to learn what asset owners care about. Not just at the level of, 'This is our general ESG integration process,' but to look at specific companies and how they think about it.

DB: We're running slightly short of time. I'd like to turn to some of what's happening at a high level, the big mainstream issues, how will that affect ESG integration? For example, the governor of the Bank of England is talking about stranded assets. The baton has now been picked up by really senior people in the global financial system.

PB: That's such a talking point in Australia at the moment.

KLM: I think COP21 and the Sustainable Development Goals are really adding momentum and providing legitimacy in some of the areas that we are particularly concerned about and actively engaging in, for example, on climate change. These global agreements help us when we meet with companies because we can point to these as external drivers and make it clear that companies can't shirk from this anymore. They do need to take climate change seriously, if they aren't already. COP21 made it clear that it was time to publish the carbon footprinting that we had been running on all our portfolios.

LL: I think certain regions respond better to the initiative at a global level than others. I realised I'm the only American around the table. Investors respond more readily to more local level legislation. We have seen way more traction, in terms of lighting a fire under investors from California, from the state Department of Insurance asking for disclosure around carbon: more than anything at a COP 21 level. As for global policy-making: for investors, they're not necessarily paying attention until something like what's going on in California happens. Right now, the SEC is looking at whether ESG disclosures should be regulated in some way in terms of disclosure standards. That gets more attention in the US than global climate policy.

RA: In Malaysia, we have pro-active regulators. When they came up with their own framework, they took into account the UN's reporting framework. Some of them incorporate it into their own framework. The stock exchange's new requirement for sustainability had some elements of the United Nations recommendations in it. They've done a good job. Some of the public listed companies need time to comprehend and adopt. The timeline granted by the regulators assists in ensuring that the companies have sufficient time to adopt.

CY: On one hand, you want to understand global best practices. People will search for those, but from discussions today, so many issues are country or state-specific, so how do you balance those challenges?

PB: It's like the saying that 'all politics being local', COP21 and the SDGs are useful for setting the tone and direction, so you can have more confidence as an investor, but at a domestic level, you want to see the regulator's policies come through. Each country will interpret that trend in their own way and this will have the most direct impact on individual companies.

The World Economic Forum's risk report over the last five years has environmental and social risk now dominating its top 10. There is a broad, global trend here that these issues are fundamentally important, but we have to apply them to our own decision-making on a day-to-day basis for individual companies and across different types of portfolios.

MS: This is a great demonstration to me that we don't understand risk. We all think we know what risk is. This led to the Global Financial Crisis. Linda mentioned carbon footprinting. It's not just about operations, it's about fossil fuel exposure, stranded assets. As an investor, you can engage companies on this, ask them about their plans to reduce emissions. Around the positive side, renewable energy, sustainable water, these are things we need to think about. Climate change will affect everything. Elon Musk changed how people thought about cars with Tesla. Europeans led the way. In Australia, we launched low carbon indexes. They do meet the short-term needs of the two-degree scenario, but there are some areas where it doesn't quite meet that. At least you end up with an 80% reduction in carbon emissions and a 90% reduction in fossil fuel exposure through a low carbon target index.

Vision Super were one of the first superfunds in Australia to shift their core investments to low carbon strategy. It's an example of how exclusion can lead to companies improving what they're doing. We're seeing climate risk as a big area of focus. People ask if it's too much of a focus. I think, if you focus people's attention on one area, and it's the most material issue we have at the moment, this is an important area we need to address. As investors, we can shift large amounts of capital to change how the world works.

DB: That's the right note to end this on. We're out of time. It's been a great session. Thanks everybody for all your input.